

Scaling-up Small and Microenterprise  
programs in the context of political-economic crisis:  
The case of the Dominican Republic.

by  
• Ken Monroe

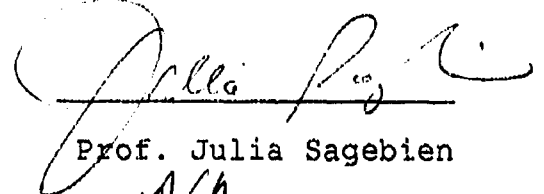
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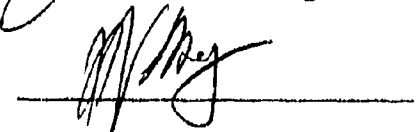
Thesis approved by



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Prof. Julia Sagebien



Dr. Henry Veltmeyer



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## Abstract

Title:      Scaling-up Small and Microenterprise programs in  
         the context of political-economic crisis: The case  
         of the Dominican Republic.

By:          Ken Monroe

Date:        28 February 1992

For the Latin American region the 1990's has been referred to as the lost decade. Two of the most pressing problems that emerged were chronically high unemployment rates and increasing poverty. In order to address these problems, small and microenterprise (SME) development programs, operating in the informal sector by non-governmental organizations (NGO's) have become increasingly popular forms of assistance. In the 1990's, SME programs are being allocated even greater quantities of resources and technical assistance to scale-up and spread their benefits to more people. This study critically assesses the relevance of the scaling-up process to the resolution of unemployment and poverty as they exist in the urban informal sector in the Dominican Republic.

In order to arrive at a conclusion, the thesis includes chapters reviewing: current theories of the informal sector; the progression of SME programs from conceptualization to scaling-up; the political-economy of the Dominican Republic; and finally an evaluation of the scaling-up institution, FONDOMICRO.

The conclusion of this study is that FONDOMICRO will be irrelevant to resolving the fundamental problems of unemployment and poverty because it lacks the capacity to alter the political and economic structures from the status-quo. Rather, FONDOMICRO is designed to give assistance to relatively large businesses that are being squeezed from credit sources in the formal system due to restrictive monetary policies. FONDOMICRO is a parallel intervention supportive of traditional economic development strategies, and structural adjustment in particular.

## **Chapter 1. Introduction**

### **I. Background**

The political and economic development of countries that are generally referred to as the Third World has been a bloody travesty. In the first instance, colonizers clouted the New World economies into a system based on nothing other than the exploitation of peoples and resources. To destroy cultures and to subjugate people and the environment meant nothing in the pursuit of enrichment. After a period of developing countries constructing independent political institutions, the resurgence of conservatism in the 1980's, continues the earlier legacy with only minor changes. In the name of global integration and economic development, developing countries transferred US\$50 billion in principle and interest payments to the industrialized nations in 1988 alone (Head, 1990 p.19). Once again, the former colonies are sacrificing their social and cultural fabrics for the wealth of the colonizers.

For the Latin American region, which will be the focus of this thesis, the 1980's is referred to as the 'Lost Decade' because much of the progress towards creating modern, industrialized countries was reversed. There are a number of factors that caused this but the debt crisis must top any list. The result of this reversal has been an increasing incidence of unemployment and poverty. One of the



worst examples is the Dominican Republic which suffers from a chronic official unemployment rate of 23 percent. In 1991, 57 percent of the population lived in poverty of which 30 percent do not consume the minimum recommended allowances of calories and protein (El Siglo, 20 May 1991, p.D1).

Like the circumstances that perpetuate these problems, the actions designed to counter-act them are dynamic. From the 1970's onwards, developing country governments, major development agencies and theoreticians began devoting more attention and resources towards what is known as the urban informal sector (UIS). This was a reaction to rapid urbanization rates and increasing unemployment and poverty. As a result, new types of development interventions were initiated that would attempt to alleviate the effects of unemployment and poverty. One such intervention that has become increasingly popular since the 1980's is Small and Micro-Enterprise (SME) development programs operated by private sector non-governmental organizations (NGO's).

The methodologies for SME programs were developed in the early 1980's and have experienced a relative degree of success compared to other interventions. However, the continuation of high unemployment and poverty indicators in the region as a whole has prompted the expansion of SME programs in terms of the resources dedicated to them and their ability to reach the target group. This process is known as scaling-up. The purpose of this study is to assess

the relevance of the scaling-up process of SME programs to alleviate poverty and unemployment in the Dominican Republic.

While a case study implies that the conclusions drawn apply specifically to the example, the thesis will argue a number of points that are valid to the current theoretical debate of the informal sector, as well as the scaling-up process in general. This is important because of the increasing pressure to resolve fundamental problems like employment and poverty and the likelihood that scaling-up will consume an increasing proportion of development assistance. It is therefore necessary to understand the issues involved so it can be done as effectively as possible.

While being critical of FONDOMICRO, the Dominican institution charged with scaling-up, the thesis attempts to be constructive in that it suggests ways which scaled-up programs can be designed to maximize their impact on the two problems described above. There is a place for scaling-up SME programs in the menu of development assistance offered to the UIS, but only if it is done in a way meaningful to the end-user, the informal sector operator. It is therefore hoped that policy makers and practitioners of SME programs can benefit some from this work.

The Dominican Republic serves as a good case study because it exemplifies many characteristics of the formation

and perpetuation of the UIS in Latin America. Also, the private sector of the Dominican Republic has one of the longest and most successful histories in developing SME programs in the region. This means that to some extent the Dominican Republic is a model for other countries to emulate.

## II. Thesis Outline

The thesis is framed by chapters 1 and 6 which serve to introduce the problem and to draw conclusions. The body of the thesis is presented in the middle chapters and is separated into two parts: theory and case study. The first part includes chapters 2 and 3, the second, chapters 4 and 5. Dividing the thesis along these lines distinguishes academic concerns from the practical reality of the Dominican case. In order to ensure that these two are intertwined, the reader should be aware that the content of chapters 2 and 4 is related, as is chapters 3 and 5.

After a brief history of the how the term informal sector came to use, chapter 2 organizes the various theories according to two sets of criteria. The first cut is whether the respective theory advocates a belief in the evolutionary or the involutionary nature of the informal sector. This is a most important distinction because it refers to whether or not the businesses in the informal sector are perceived to

have the capacity to accumulate capital and grow in a manner beneficial to their owners. The basis for assistance can only be premised on the belief in the evolutionary capacity of informal businesses. The second distinguishing criteria for categorizing the theories is the mechanism advocated for resolving the problems of unemployment and poverty. The theories are divided by whether they support structural reform or resource transfers. SME programs are justified according to the belief in the resource transfer mechanism. The objective of chapter two is to locate SME programs, and their advocates, within the current debate about the nature of the informal sector and the solutions proposed. The discussion will also identify the critics of SME programs and the arguments they use to refute the assumptions of assistance. A preliminary analysis of the validity of each theory will be made with a more thorough test in chapter 4.

The problem with the above categorization is that confusion associated with defining the informal sector has allowed a theory to emerge which incorporates both evolutionary and involutionary principles, as well as resource transfer and structural change. The concept of a 'Heterogeneous' informal sector therefore defies categorization according to the criteria listed above and is therefore treated separately. For political and practical reasons this concept dominates the discussion of the informal sector today.

For the purposes of academic study, the concept of heterogeneity renders the term informal sector irrelevant. However, from a practical perspective, it does not obscure the issue of evaluating SME or scaling-up projects. This is because the concept of heterogeneity, clearly stratifies the informal sector into three groups and defines the type of assistance needed to reach each strata effectively. Stratification, in essence clarifies the issue of SME assistance because it recognizes that different businesses need different types of assistance. In assessing SME or scaling-up programs, it is therefore possible to determine the beneficiaries by assessing the types of services they provide. A key assumption of this thesis is that if informal sector assistance is to be given, it should be available to all. Therefore SME program designs which reach all strata should be supported in scaled-up programs.

Because the thesis recognizes the need for structural change, chapter 2 also contains a short but pertinent discussion about the process of structural change. Two types are identified: internally induced models of reform and externally induced models. Of these two the latter model predominates in the form of structural adjustment policies (SAP's) and through the power of conventional development theory. The chief proponents of SAP's are International Monetary Fund (IMF), World Bank (IBRD) and traditional forces within governments of both developed and developing

nations.

The discussion within the thesis is in no way comprehensive of SAP's or their impact on the economy, but because SAP's form the guiding principles of macro-economic strategy, they affect every aspect of the economy, including the informal sector. Therefore any discussion that does not consider the influence of these policies is incomplete.

The objective of this discussion is to show that SAP's add to the growth of the informal sector and therefore cannot be part of the solution. Moreover, the scaling-up process in the Dominican Republic can be envisioned as a response by donor agencies and the private sector, to meet the increasing demand for credit by SME's due to the restrictive fiscal policies of SAP.

Chapter 3 zooms in on development of SME programs from their conception to state-of-the-art discussions of scaling-up. The chapter has two distinct components: the first focusing on the different types of SME programs and their method of evaluation, the second discusses relevant institutional features of the scaling-up process.

The first part is particularly important because there are different designs of programs, each with distinctive objectives and capacity to reach clientele with essential services. The method of impact evaluation is crucial because most programs are reliant upon donors for funding and thus some form of performance criteria. The discussion below

points to problems in both the tools and methodology of existing evaluation techniques. The result of these problems is funding being concentrated to one program design. This has a detrimental impact the quality of assistance to the informal sector as a whole because each type of program reaches only a certain type of clientele. The conclusions drawn from this section have direct implications for donor agency policy.

The second part of the chapter can only deal with the rational for scaling-up and the institutional aspects of the process. At present there are few large programs existing in the world and those in Latin America have begun only very recently. Evaluation of their impact would be premature. However, from this discussion, it will be possible to hypothesize how a scaled-up program would operate in order to maximize both the resources available and impact on the problems identified.

The theoretical discussion of the causes and solutions of the informal sector and as well as the review of SME programs and their impact provide the grounding to pose the thesis of the study. The thesis is: Due to impotence of FONDOMICRO to alter existing economic and political structures from the status-quo, it is irrelevant in terms of solutions to unemployment and poverty in the UIS in the Dominican Republic.

To make an assessment of the thesis statement it is

first imperative that the theoretical premises on which it is based is confirmed. The description of the development strategy since 1965 in the Dominican Republic provided in chapter 4 is intended to do exactly that. It will be apparent from the evidence that the UIS is the result of structural features in both the economic and political spheres. Furthermore, it will be shown that the effects of externally induced model, SAP, have encouraged the growth of informal activities. Therefore the poverty and unemployment that exists in the UIS can only be eliminated through interventions that aim at changing both these structures and reorienting policy away from SAP. From the evidence presented it will be possible to compare the theoretical premises upon which FONDOMICRO is based with the reality of the UIS in the Dominican context.

The fifth chapter assesses the impact that FONDOMICRO will have on job creation and poverty alleviation in three ways: by looking at its institutional characteristics; its program components; and by assessing the impact that its clients, the SME programs, have on achieving the objectives of poverty alleviation and job creation. The institutional characteristics are essential to evaluate because they dictate what type of client will be able to access the capital and services provided by FONDOMICRO. This in turn is very relevant to the type of informal business that will ultimately receive assistance and hence the success in



reaching the objectives. The institutional characteristics also indicate the capacity for FONDOMICRO to act for structural change in both the economic and political spheres and the type of structural change advocated. The second part of the analysis is done by assessing the impact of one program, the Asociacion para el Desarrollo de los Microempresas Inc. (ADEMI). This is possible because the criteria of FONDOMICRO is suited to ADEMI and encourages the formation of ADEMI-like institutions. ADEMI is also the only SME program that meets the criteria of FONDOMICRO at this point in time.

While it is impossible to state for certain what relevance FONDOMICRO will have on the UIS in the Dominican Republic, it is possible to evaluate its potential because it has been given certain characteristics: objectives; structures; and performance criteria. These characteristics suggest that FONDOMICRO will function in a particular manner and by assessing how this manner relates to the real problems of the UIS, a conclusion about FONDOMICRO's relevancy can be made.

Ultimately the argument is that because the problems of unemployment and poverty in the UIS are directly related to the economic and political structures of traditional development strategy, without altering these structures the problems cannot be resolved. The solution for the Dominican Republic is not more global integration. Global integration

has resulted in industrialization that relies on both cheap labor and external markets. It has destroyed domestic industry and creates reliance on food imports and aid to meet domestic demand. Correcting problems in these areas can only be done through rethinking the development strategy and the fundamental objectives of the nation. Due to the historic orientation of the political structure toward the traditional strategy a new political consensus must form. Development programs that do not assist in this process are palliative and detrimental to the well-being of the vast majority of people.

### III. Methodology

This study is comprised of both primary research in the Dominican Republic and secondary research comprised of books, articles and other printed material. The primary research was conducted between April 22 and June 20, 1991. Interviews were conducted with employees of FONDOMICRO, ADEMI, CIECA, USAID and IED. The bibliography contained within shows the scope of materials covered.

## **Chapter 2. The Informal Sector, poverty and unemployment: A review of the current theories**

### **I. Introduction**

Development theory prior to the 1970's was dominated by large-scale industrialization projects. The basic idea was that development of the Third World must imitate the processes followed by today's industrialized nations: the transfer of employment from the over-populated and unproductive agricultural sector into a modern industrial manufacturing sector in an urban setting<sup>1</sup>. The idea of dual economies is evident in many of the terms used during that era: "modern vs traditional, urban vs. rural" and a variety of terms that connote a superior vs inferior relationship.

Developing country governments and the major multilateral aid agencies like the World Bank and the International Monetary Fund (IMF) encouraged policies that advanced both urbanization and industrialization. In Latin America, the efficacy of this strategy is shown by two figures. In 1950, 55 percent of the labor force was employed in the agricultural sector but by 1980 it had shrunk to 32 percent (PREALC, 1985 p.3). Secondly, during this period the GDP of the region as a whole grew at over 5 percent annually (Tokman, 1982, p.126). In large part, governments and

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<sup>1</sup> Reference here is to the classic theories of A. Lewis and W. Rostow that dominated thought at the time.

experts were satisfied with this transition because development was strictly equated to the growth in GNP and in per capita income. It was the predominance of this mentality that allowed the term 'miracle' to be applied to the development process of some Latin American countries<sup>2</sup>.

The failure of the modern sector to generate sufficient levels of employment to absorb the growing urban work force, required theorists to reassess this strategy. The reality of this situation is amplified today by global recession and structural adjustment programs (SAP's). Tokman (1989) estimates that some 30 million workers in Latin America are employed in the informal sector, an increase of 39 percent in the 1980's. Moreover, it is projected that to accommodate the increase in the labor force, developing countries will have to create 120,000 new jobs per day (MEDA, 1991, p.7). The historic sluggishness of the modern sector to create jobs means that employment must be found elsewhere. The informal sector will be the source of income for the majority.

In this sense the informal sector, job creation and income generation are inextricably linked as the means of poverty alleviation in developing countries. However, assistance based on inadequate theoretical grounding is

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<sup>2</sup> The term "miracle" is used to describe both Brazil's development in the mid-1960's and 1970's and Chile's in the late 1970's and late 1980's. Since this time, the models have been reassessed and harshly criticized for their legacy of income inequality, poverty and social and political costs.

ineffectual and in the long run detrimental because it diverts attention from the true sources of the problem. It is therefore important to assess both the political-economy of the term "informal sector" and the theories that explain its place in development policy.

## II. Development Redefined: politics and ideology of the informal sector

At a global level the most persistent advocate of the informal sector has been the International Labour Organization (ILO). By 1970 the ILO became increasingly aware of the rising incidence of poverty and unemployment and initiated a series of studies under the World Employment Program designed to investigate the problem of urban poverty. The objective was to provide policy advice to aid the estimated 300 million un- and underemployed in developing countries (ILO, 1976)<sup>3</sup>. The fundamental contribution of these studies was to reorient the development process. Rather than simply equate development with increases in GNP, it argued that distributional policies were necessary. Paralleling the work of the ILO was a series of IBRD/IDS studies that concluded virtually the same thing: highly skewed income distributions needed to be corrected through clear policy initiatives (Chenery, 1974).

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<sup>3</sup> The city studies were carried out in Calcutta, Jakarta, Abidjan, Lagos, Sao Paulo and Bogota. The country studies were carried out in Colombia, Sri Lanka, Kenya and Iran. These reports have received significant critical attention in Moser, 1978 and in Thorbecke, 1975.

Two new concepts emerged in the development literature as the result of these multilateral institutions:

"Redistribution with Growth" (RwG) and the "Informal Sector".

Framing distributional aspects within the question of development, the ILO and RwG disassociated themselves from the predominating 'trickle-down' theories of classical laissez-faire economics. However, the underpinnings of the economic and political systems at work were not questioned. Leys argues that in determining income distribution, RwG gave no account of the political, legal or religious control that hinders the accumulation of capital, e.g. the small farmer forced to sell land to survive, the repression of labor unions, etc. He concludes therefore, that "a narrowly conceived model of income distribution defines a fairly narrowly restricted area of strategic action" (Leys, 1975, p.5). In this sense, the informal sector became identified as the target for redistribution policies as a recognition of certain failures of the development strategy, but also as a means to maintain it. Subsequently, the unleashing of mainstream social scientists to show that informal operators were the victims of government mismanagement, associated with import-substitution policies, the high rate of rural-urban migration, labor market distortions and population growth, signified that the term 'informal sector' "embodied policy implications which were convenient for international

organizations and politically middle-of-the-road governments" (Bromley, 1979, p.1036)<sup>4</sup>.

By the mid-1970's the term was firmly entrenched in development literature. The rapid ascendancy of the term is itself a hint of its political utility. Unfortunately, this rise was not matched by a conceptual clarity. The result was the beginning of a long and inconclusive academic debate about the composition, nature and relevance of the informal sector. Outlined below are some of the theories which explain its meaning. Rather than delve into the nuances of each theory, described below are theories of current utility and particular relevance for the discussion on the development and evaluation of program interventions<sup>5</sup>.

### III. Theoretical Approaches

The fundamental disagreement regarding the conceptualization of the informal sector is whether or not activities included within it have the potential to accumulate capital and therefore be promoted as a poverty alleviation measure. While 'evolutionary' and 'involutionary'<sup>6</sup> are the terms most commonly used, others such as 'substitutability vs. complementarity' denote the

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<sup>4</sup> Also see Sethuraman 1981; Connolly 1985; Guerguil 1988.

<sup>5</sup> This account of the theories of the informal sector is not comprehensive. A full account of these debates can be found in Rogerson, 1985, and less thorough reviews in Bromley, 1985 and Schonwalder 1991.

<sup>6</sup> These terms first used first by Weeks in 1975.

same principles (Hugon, 1988 p.19).

'Evolutionary' development occurs when the growth of output per head and capital accumulation rises in the context of increasing labor supply in the sector. Those who believe in the 'evolutionary' nature of the informal sector are the advocates of assistance. Below, these approaches are classified as the assistentialist and the neo-liberal. Common to both of them is the portrayal to some extent of the entrepreneurial spirit of the informal operator contrasted against limited access to resources (i.e. credit, production inputs, markets, technology or training). They do differ by how they see solutions to the informal sector occurring. The assistentialists believe the existing structures are adequate and therefore allocating resources to the sector is essential. Assistance aimed at one or all of the above limitations benefits not only the individual but also the development of the society. Empirically they show that saving, capital accumulation and income generation do occur at the business level. The neo-liberals believe changes in the economic structure that enable the market to work more efficiently are sufficient to allow UIS businesses to grow.

Those who believe otherwise point out the 'involutionary' nature of informal businesses and the inappropriateness of assistance. 'Involutionary' refers to static output and capital accumulation rates as the labor



force in the sector increases. This implies increased employment but declining wages and/or incomes. Involutionist writings stress the relationship between the formal and informal sectors and show the latter to be subjugated in an exploitative and detrimental manner. In this study they are represented by the neo-marxist and organizational restructuring approaches. The consequence of their theories is that assistance targeted towards the UIS is futile since any benefits will be transferred to the capitalist class. They consider assistance a form of 'selective upliftment' as opposed to development. The solution they seek is to change the structure of society and the nature of capital accumulation.

#### A. Heterogeneity

As explained in the introduction, heterogeneity refers to both evolutionary and involutionary components as well as requiring resource transfer and structural change. It is the first theory discussed because it is the favored theory in use today by practitioners for reasons which will soon be evident.

The organization that instigated this theory, the Programa Regional Economica para America Latina y el Caribe (PREALC)<sup>7</sup> defines the Informal Sector as:

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<sup>7</sup> PREALC is a branch of the ILO based in Santiago, Chile

"a set of productive activities that share the common feature of employing a number of people who would be unable to find employment in the modern sector and must generate their own employment with relatively little access to the factors of production that complement the labor supply" (Mezzera, 1989 p.47).

In empirical terms, PREALC identifies the urban informal sector as the difference between the total urban work force and the total work force employed in modern, high capital/labor businesses (ibid p.49).

PREALC's version of the informal sector is normally regarded as the Structuralist view (see Annis and Frank, 1990; Schonwalder, 1991), although this is not entirely accurate. Pure Structuralism would imply that solutions to the informal sector could only be found in altering the economic and political structures at the national or global level. While clearly Structuralism does form a large part of its conceptualization, PREALC also recognizes a growth component to the UIS (see Tokman 1978 and Mezzera 1989). PREALC envisages that in certain instances, resource transfer without structural change can benefit informal sector enterprises. In this sense the concept of "heterogeneity"<sup>8</sup>, introduced by PREALC allows for involutionary and evolutionary forces to exist simultaneously and its conception is a hybrid of

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<sup>8</sup> This term was first introduced in Tokman, 1978. He describes it as an intermediary position between petty commodity production and evolutionary growth but closer to the former.

## Structuralism and Assistentialism.

The Structural component of the informal sector is composed of people excluded from modern sector employment as opposed to those who remain outside of it (Mezzera, 1989 p.49). These people tend to enter highly competitive but low productivity niches of the economy normally associated with self-employment in the service and commerce sectors. Generally, their objective is to survive rather than accumulate capital. Due to rudimentary technology and minimal technical innovation, productivity of these sectors is low. Incomes in them are likely to decrease unless other activities pass on the benefits of their productivity gains in the form of lower prices to consumers (Beinefeld, 1975 p.58). Because this is not generally the case, incomes in these activities tend to decline. In times of recession these activities will grow the fastest due to rising unemployment and low entry barriers. In this case competition in these activities increases faster than the markets they serve and hence incomes are reduced (Tokman 1989 p.1070).

The growth component of the informal sector is comprised of entrepreneurs who compete in large formal businesses under generally oligopolist market conditions<sup>9</sup>. These tend to be manufacturing activities, retail services

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<sup>9</sup> Mezzera states that two characteristics of the modern sector in Latin America are capital intensity and oligopoly (Mezzera, 1989 p.54).

and transportation (Tokman, 1989 p.1070). Where strong oligopoly forces exist, informal sector firms can be expected to lose markets and returns in the long-run as the surplus is increasingly extracted from above by better-equipped formal operations<sup>10</sup>. In all other cases there is the possibility for these businesses to increase income and accumulate capital. It is at this level where resource transfer programs will be effective. Figure 2.1 shows the relative weight of the structural vs. growth components of the informal sector in selected countries.

Figure 2.1      Structure of Informal Sector:  
percentage of business by no. of employees  
for three Latin American countries.

No. of employees	Dominican Republic(a)	Peru(b)	Colombia(c)
1	50	81.86	71.3
2-5	38	17.66	25.0
5-10	8	.46	3.7
>10	3		

a)national survey

b)includes only Lima, Huancayo and Chiclayo

c)includes only Bogota, Cali, Medellin and Baranquilla

Sources: MSI 1989, Chavez O'Brien, 1987; Lopez,  
Corchuelo, Zorro, 1990.

<sup>10</sup> The degree of oligopoly is related to the size of the market for a given product and the capacity to introduce technology into the production process (Tokman 1978).

According to PREALC, the genesis of the UIS is due to two primary factors. The first is the 'dynamic insufficiency of imitative capitalism'<sup>11</sup>. Secondly, there has been a persistence of high inter- and intra- sectoral productivity rates in Latin America, while in the industrialized countries the discrepancies tended to decrease<sup>12</sup>. Wide disparities of productivity signify segmentation of technical processes and create difficulties for people to move freely between between sectors and industries. The role of foreign investment and capital intensive technology is obviously central to this conception, but the role of government policy is not overlooked (Mezzera, 1989 p.53).

Implicit in the above descriptions is a conception of an informal sector that is linked and subordinate to the formal sector. In this sense, although PREALC uses the two terms, formal and informal, they are not meant to denote the atomistic, dualist perception initially suggested by the ILO. Furthermore, it is implicit that the concept of heterogeneity exists at two levels: in the degree of

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<sup>11</sup> Dynamic insufficiency was hypothesized by Raul Prebisch and is a foundation of Structural analysis. It describes Latin American capitalism as a process where domestic profits are made but instead of being reinvested in productive capacity and capital accumulation a significant portion is spent as conspicuous consumption or on consumptive capital. Between 1978 and 1981 the quantity of non-essential imports into Mexico was valued at \$14 billion, in Brazil \$10 billion and Chile \$5 billion. This amounts to per capita expenditures of \$79 in Brazil, \$200 in Mexico and \$513 in Chile (Development Dialogue, 1989, p.47).

<sup>12</sup> The assessment was made by V. Tokman in CEPAL review Aug 1982 in which he compares the development of labor markets in Latin America from 1950-80 with industrialized countries, particularly the U.S. in similar stages of their development.

heterogeneity exists at two levels: in the degree of exploitation between businesses in the dominant and subordinant sectors and also within the activities characterized as informal. Research has therefore focused on distinguishing levels of the informal sector to identify which types of business can expand in an evolutionary way and what are the conditions necessary for this to occur. As will be seen shortly, the strata are identified as: small, micro and survival businesses. However, over the long-run, Tokman concludes that as a whole, the informal sector can expect declining incomes due to stagnating productivity and markets in the face of an increasing labor supply, continuing global recession and implementation of SAP (Tokman, 1989 p.1068).

In recommending solutions for the informal sector, Tokman suggests three packages of policy and direct assistance that will begin the process of eliminating unemployment and poverty: the productive assistance package (resource transfer), the welfare package and the legal-institutional package (structural change) (Tokman, 1989)<sup>13</sup>.

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<sup>13</sup> This article was written while Tokman was with the ILO in Geneva. Never-the-less, it fairly represents his previous views when he was with PREALC. Moreover, his return to PREALC signifies that the organization will follow this course.

## B. Evolutionary Approaches

### 1. Assistentialist

The assistentialist approach is comprised of international or regional aid agencies such as the ILO and the Inter-American Development Bank (IDB). It also includes national aid agencies such as CIDA and USAID, as well as international and local NGO's which develop SME programs.

The conceptualization of the informal sector by evolutionists was originally in the context of a dualist structure first set forth by the ILO. It perceived two sectors of the economy functioning in a mutually exclusive manner, each with its own dynamics and growth potential (see Table 2.1)<sup>14</sup>.

The ILO identified the growth of the sector as a function of rapidly growing urban populations and the inability of the manufacturing sector to create employment. Both of these are revealed by distortions in the labor markets, such as an oversupply of unskilled workers, or, as the result of macro-economic policies that favor capital intensive industrialization<sup>15</sup>.

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<sup>14</sup> Since that time, research has shown that there are a variety of linkages between the sectors, but to a large extent the original characterization distinguishing them remains in use today.

<sup>15</sup> A complete discussion of the causes of labor market distortion can be found by Mezzera, ch.3 in Berger and Buvinic, 1989.

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Table 2.1 Dualist characterization of the economy

Informal	Formal
Ease of entry	Difficult entry
Indigenous inputs predominate	Overseas inputs
Family property predominates	Corporate property
Small scale of activity	Large scale activity
Labour intensive	Capital intensive
Adapted technology	Imported technology
Skills from outside of school system	Formally acquired skills
Unregulated competitive market	Protected markets (e.g. tariffs, quotas, licensing arrangements)

source: ILO Kenya Report, 1973

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The ILO saw the businesses themselves as contributors to the national economy. In putting a positive light on the activities within the informal sector, its studies concluded that they were more efficient users of scarce resources, particularly capital and labor. One ILO study suggests that the informal sector produces greater value-added per unit of investment than the formal sector (G. Jurado et.al. in Sethuraman, 1981 p.121-143). The economic viability of these activities provided the justification for assistance.

As evidenced above, this characterization of the informal sector views the business as the basic unit of analysis. As a result it became distinguished according to criteria of size, level of assets or sales, type of technology used and capital/labor ratios. The problems in



operationalizing these characteristics across any geographic distance is enormous and well documented (see Connolly, 1985; Schonwalder, 1991 p.40). The characteristics are also bad because they are subjective. In 1985 in a report for USAID, Blayney and Otero used an upper limit of 25 employees to distinguish small enterprises in the Latin American context (Blayney and Otero, 1985 p.11). In 1990, USAID in the Dominican Republic defined it as consisting of businesses with fewer than 50 employees (USAID, 1990 p.1).

The approach taken by the ILO aims at bringing back into balance the supply and demand factor of the labor markets. They emphasize training programs for workers, and reducing discriminatory policies that favor formal sector firms such as: licensing arrangements; tariffs; exchange rate policies and ceilings on commercial interest rates. In the agricultural sector, land reform was considered but its political implications limited the ILO to advocate levelling the playing field between the two urban sectors and to develop programs of direct assistance.

A more active manner of promoting resource transfer to the UIS is to offer credit or technical assistance through local NGO's. In this area the big players are USAID, the IDB and international and local NGO's. This point of view is nestled squarely in the precepts set forth by the PREALC theoreticians on the composition and genesis of the informal sector.

While the literature of these organizations is dominated by program design, evaluation, and impact assessment, it has contributed to the understanding of the differentiation within the informal sector and where assistance is most likely to maximize its economic impact<sup>16</sup>. Table 2.2 shows the different levels of businesses within the informal sector and their distinguishing characteristics as they are currently conceived. Similarly, a hierarchy from best- to worst- paid occupations in the entire economy constructed from surveys carried out in Costa Rica, Colombia and Peru is as follows: owners of formal shops, self-employed professionals, owners of informal shops, public employees, workers in formal firms, male informal self-employed, workers in informal firms, female informal self-employed and domestic workers (Tokman, 1989, p.1070). By distinguishing these layers, the assistentialists are able to better direct resources to businesses or occupations where it is thought to have the greatest impact. Through showing increases in incomes, job

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<sup>16</sup> See the methodology section of the bibliography.

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Table 2.2 Characterization of the Informal Sector

Survival: self-employed activities of extremely low productivity

Characteristics	<u>Microenterprise</u>	<u>Small Enterprise</u>
No. of workers	Roughly 10 or fewer full time employees	Roughly 10 to 50 employees
Work force	Primarily family labor	Largely hired workers
Financing	Rely almost entirely on family savings, cash transactions, informal money lenders and supplier credit	Limited access to formal financial markets, commonly rely on informal markets, supplier credit and reinvested earnings
Management	Little management specialization	Some management specialization
Technology	Traditional based on widely existing technical knowledge, labor skills and raw materials and supplies. Labor intensive	Less traditional, some innovation required. Capital investment often required.
Products	Goods and services are generally simple, prices are low, cater to basic needs of low income consumers	Goods and services range from simple to more complex, span a relatively broad range of consumer types
Markets	Typical y highly localized through simple marketing channels	Marketing patterns somewhat more complex
Competition	Intense as a result of ease of entry	Less intense because of barrier to entry
Earnings	Returns to entrepreneurs generally are low	Returns higher but riskier

Source: USAID, 1989. Bancosol project paper

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creation and employment among the clients of programs, this literature is at the forefront of refuting the involutionists and is quite oblivious of their criticisms.

Four recent studies have been instrumental in shaping the assistentialist position. They argue in favor a more direct approach towards what has been referred to as the

direct approach towards what has been referred to as the "missing middle" of developing countries economies (see Figure 2.2).

Figure 2.2      Distribution of Manufacturing  
Employment among Cottage Shop, Small and  
Medium Industry, and Large Industry: Selected Economies  
and Years.

Economy	Year	Cottage shop (1-4 workers)	Small and medium industry (5-99) workers	Large industry (100+ workers)
Colombia	1978	42.5-47.5	28.7-29.9	24.0-27.6
Philippines	1975	66.0	8.0	26.0
Nigeria	1972	59	15	26
India	1975	60	18	22
Ghana	1970	78	7	15

source: Berry, Cortes and Ishaq, 1987 p.18

As indicated in the Figure, there is a tendency for developing countries to have a high concentration of employment in both the smallest and largest firms, with fewer in the small and medium categories. The exception in this case is Colombia, which the authors claim as beneficial for the country.

In assessing the potential to assist these levels, the first three studies argued that although single person businesses are by far the most numerous, assistance should

not be given<sup>17</sup>. Leidholm and Mead concluded that within the developing countries studied, the utilization of capital was highest among one-to ten-person businesses, but the one person operation was least economically viable (Leidholm and Mead, 1987). Other studies in India (Little, Mazumdar and Page, Jr. 1987) as well as in Colombia (Cortes, Berry and Ishaq, 1987) both concluded that larger firms were the most efficient and instrumental in employment creation<sup>18</sup>.

"If supply side intervention in favor of small firms is planned, the objective must be to spot potential winners and speed them on their way. Since it is difficult to spot winners at the starting gate, it follows that such intervention is more likely to be successful at a stage where there is already evidence of success" (Little, et.al., 1987 p.313).

The fourth study suggests that the immediacy of action directed to the poorest be restrained if these efforts might impinge on growth of the middle in the future (Biggs, Grindle and Snodgrass, 1988 p.13). The impact of these findings have been to orientate direct assistance programs towards "the progressive minority", primarily larger businesses in the production sector, in order to maximize the impact of aid expenditures on the possibilities for job creation and income generation.

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<sup>17</sup> As well as Figure 2.1, the PISCES study estimated that in the countries studied (The Dominican Republic, Costa Rica, Kenya and Egypt), one- or two- person businesses outnumbered larger organizations by a ratio of 3 to 1. See Ashe, 1985 pp.4-12.

<sup>18</sup> Both of these studies were sponsored by the World Bank.

Limiting assistance to larger businesses is premised on the assumption that intensive growth; the increase in size of businesses as opposed to extensive growth; the creation of new businesses, is the most important form of job creation within a country and that single wage employment is sufficient to meet basic needs. It also assumes that production firms have better potential for intensive growth than commercial and service operations. A recent study in the Dominican Republic which limited its sample to food production, artesania, mattress making and reupholstering, clothes production, furniture making/carpentry, and shoemaking and other leather work, indicates that these industries are considered to have the best opportunities to expand and are the most likely beneficiaries of resources transfers<sup>19</sup>.

## 2. The Neoliberal Approach

During the RWG period, the World Bank suggested that the informal sector was the result of distorted labor supply policies, including minimum wage legislation and the rationing of public jobs. The effects of these policies fragmented the labor force into high paying 'protected' vs. low paying 'unprotected' jobs. Even more significantly, it

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<sup>19</sup> Regino's IDB sponsored study of ADEMI focused exclusively on these areas of production. In the overall program they represent 27 percent of all activities financed, 34 percent of all clients and 47 percent of all the beneficiaries.

caused the orientation towards capital-intensive industrialization because minimum wages exaggerate the cost of labor (Mazumdar, 1975). The World Bank encouraged the removal of policies that prohibited a free mobility of labor.

The development of this school of thought in the 1980's is most significant because of its impact on reformulating how the informal sector is conceived. It also provides the basis of integrating solutions to the problems of the UIS to the policies of SAP. The theory is centered around the work of Hernando de Soto of the Instituto de Libertad y Democracia (ILD) in Lima, Peru. It has also been referred to as the 'Legal school' and the 'New Right' (Annis and Franks, 1989 p.16). This theory champions the case of freely functioning economic markets.

The argument of the Legalists is that inappropriate laws and/or an over-bureaucratization drives entrepreneurs into the informal sector. The market, they argue, has never functioned properly in Latin America, instead, policy has always been made to serve the interests of the domestic elite class. Therefore the structural bias of policy is inherent. De Soto regards the existing economic system as mercantilist and the informal sector as the formation of a true market economy (see de Soto, 1989, chapter 7 "The parallel with Mercantilism").

Central to this theory is the identification of costs

induced by the legal system that make the choice of operating formally or informally nothing more than a rational business decision. The costs of formality are determined by the 'costs of access' (i.e. fulfilling the procedures of registration and licensing) and the 'costs of remaining' formal (i.e. payment of taxes, the cost of meeting labor legislation and other indirect costs). In a sample of industrial firms surveyed, these costs were estimated to be 347.7 percent of after-tax profits and 11.3 percent of their production costs (de Soto, 1989, p.148). The costs of becoming formal are contrasted to the inferior costs associated with informality, (i.e. the cost of avoiding penalties, the cost of net transfers, the cost of evading taxes and the labor laws). Finally, there are 'costs of the absence of good laws' which describe societal losses in terms of not having adequate protection so as to encourage development of businesses. These costs are: not having property rights; the inability to use the contract system; and the inefficiency of extracontract law (de Soto, 1989 p.131-187).

Two examples from de Soto's book illustrate these points. In the first case, the lack of property rights granted to squatter settlements are a major hindrance in two ways: a) the constant threat of expropriation creates uncertainty, resulting in people not investing in construction; b) no land title means no collateral and lack



of access to formal credit. In a second case, the ILD went through the procedures of formally setting up a small factory with two sewing machines. It took 289 six-hour days, at an estimated cost equivalent of thirty-two times the monthly minimum living wage (de Soto, 1989 p.134). De Soto concluded that appropriate legislation would stimulate construction and businesses in the first instance, and that the procedures of formalization make informality the only realistic choice.

The ideas of de Soto have reached a wide audience. They were disseminated through agencies like the World Bank and the international press<sup>20</sup>. "El Otro Sendero" became a must read in development literature<sup>21</sup>. They also formed the basis of the failed Presidential campaign of Mario Vargas Llosa in 1990. That de Soto now sits as an advisor to president Fujimori further emphasizes the political appeal of his ideas. While acceptance of the neo-liberal position was wide, there was a strong reaction against this analysis from both empirical and theoretical angles (see Tokman 1989 and Rossini and Thomas, 1990).

The solution advocated by the ILD and the "New Right" is not so much direct assistance to the informal sector as structural reform. They argue that removing bad laws and by

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<sup>20</sup> The World Bank Development Report, The Economist and The New Internationalist during 1987 all quote figures from El Otro Sendero which implies they are considered both accurate and relevant.

<sup>21</sup> One example is *International Health and Development*, March/April 1989.

allowing the private sector and the market to prevail changes in the political and economic structures will occur automatically for the benefit of the informal sector. By promoting market liberalizing policy reforms and privatization, SAP's bring into practice this theory.

### C. Involutionary Approaches

#### 1. Neo-Marxist Approach<sup>22</sup>

The neo-marxist approach challenges two basic tenets of the evolutionists: that the informal sector is a new feature of the economy; and that it has potential to accumulate capital. To the contrary of the former, this approach states that the informal sector, as a form of petty commodity production, has existed as a fringe activity over a large period of time. "Petty commodity production never has constituted the dominant or total production of a society but has always been articulated within another wider social formation, whether this be dominated by feudalism or capitalism" (Moser, 1979 p.1057). In this sense, the 'informal sector' is simply the reconfiguration of an old phenomenon mistakenly considered new because of its appearance in a new historical context.

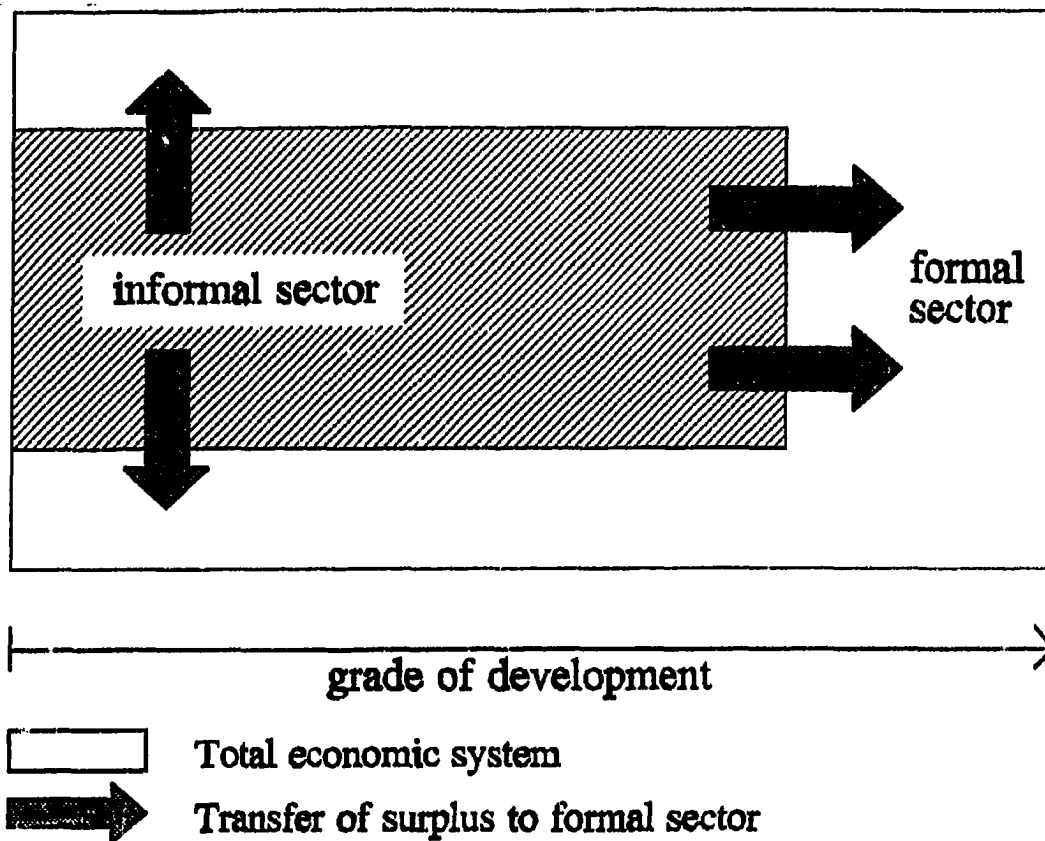
To the contrary of the second, it is argued that petty

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<sup>22</sup> The literature supporting the petty commodity production theory is diverse. Well known authors include Bienefeld, McGee, Moser, Birkbeck, Bromley and Gerry. Books include Bromley and Gerry, 1979 Casual Work in Third World Cities, Wiley and Sons; Bromley, 1985, Planning for Small Enterprises in Third World Cities, Pergamon Press.

commodity production is not able to accumulate capital because its role is to subsidize and enhance accumulation in the formal sector. It does so in three main ways: a) it provides a pool of labor which can be readily drawn upon in times of economic expansion; b) it prompts those with jobs to work harder and demand less; and c) it lowers the wage rate (Kay, 1989 p.103). For these reasons the informal sector is linked to the concept of the industrial reserve army introduced by Marx. Furthermore, subjugation of informal businesses is evident through the following mechanisms: a) informal businesses are dependent on large scale industry for inputs; b) the terms of trade are weighted against the informal sector; c) the consumer markets for informal goods are limited in size in the sense that when they become large, they will be taken over by large-scale modern industry (Beinefeld, 1975, p.56). In this manner, the informal sector has a functional purpose to the formal economy and all activities in the informal sector contribute to the transfer of value upward to the formal. This is shown graphically in Figure 2.3.

**Figure 2.3**



Source: Kleinekathoefer, 1987

Rather than focusing on the characteristics of the businesses, the neo-marxist's put the relationship between the formal and informal sector businesses at the center of analysis. To do so, work in the informal sector is divided into a number of categories but is generally regarded as casual work which denotes small-scale exploitative or low

remuneration activities<sup>23</sup>.

By studying the relationship between the two sectors, the neo-marxist approach transcends the dualist conception of the economy as formulated by the ILO. Furthermore, by relating informality to something other than capitalist production, neo-marxists consider the concept of Heterogeneity, as introduced by PREALC, a fallacy because it combines both capitalist and informal modes of production.

It is also not possible for neo-marxists to come to terms with the idea that transferring resources to any target group is an acceptable strategy of development when the roots of the problems are structural. Criticism of the SME programs and the assistentialists' position is elaborated below:

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<sup>23</sup> To analyze the nexus of job types that exists in a real economy, Bromley and Gerry divide work in developing countries into five categories: four "crudely divided and occasionally overlapping categories" under the heading of 'casual work' and one optimal condition of no-wage employment. Within the casual work category, one pole is represented by short-term wage work and the other by 'true self-employment'. Two intermediate positions called 'disguised wage-work' and 'dependent wage-work' represent the remaining categories (Bromley and Gerry, 1979 pp.5-7).

"Time series statistics on the numbers of small enterprises may indicate growth, stability or decline in the size of the collectivity, but they show nothing of the dynamics of foundation, expansion, collaboration, exploitation, contraction and extinction which affect individual enterprises. Knowledge of these dynamics is generally very limited, and as a result, "micro-intervention" to support or limit individual small enterprises is generally inefficient, highly discriminatory, and susceptible to paternalism, favoritism, corruption and victimization. It is therefore far more important to regulate the broader economic, social and physical environmental conditions which affect the numbers, types and average size of small enterprises, than to support or constrain individual enterprises on a highly selective basis. Those constraints which are applied should be few in number, simple in application, and applied to ALL enterprises, or ALL enterprises in a specific economic activity. Similarly, the supports which are applied should be few in number, simple in application, and applied to, or at least potentially available to, ALL enterprises in a specific economic activity or pilot area" (Bromley, 1985 p.333. The emphasis is Bromley's)

This statement is one of the most pertinent critiques of assistance programs and with it, Bromley dismisses the need for further investigative studies describing or formulating policy towards categories of "small enterprise sector", the "informal sector", "petty commodity production" or "other such heterogeneous aggregates" (ibid p.334). The first sentences define the limitations of the supportive evidence brought forth by assistentialists and the latter reaffirm the need for changes at a policy or structural level.

The resolution to poverty and unemployment in the UIS can only be found in altering the structure of capitalism and accumulation in the society. Bromley suggests that five

specific policy areas be targeted for research and analysis of their impact on informal activities: Deregulation, Law and Order, Urban Design, Organizations and Participatory Planning are singled out for significant reformulation. Altering these structures to allow greater equity in the political and economic systems will begin to resolve the problems of the UIS as described above.

## 2. Organizational Restructuring<sup>24</sup>

This theory positions the informal sector in the same subordinate manner as the neo-marxist approach, however, the dependency between formal and informal sector is exactly opposite: "The organization of "formal" capitalism in peripheral underdeveloped countries appears profoundly dependent on the informal sector, and this dependence extends beyond the way workers in that sector take care of their own needs" (Portes, 1978 p.54). Central to this notion is the idea that formal sector production in developing countries is externally oriented and is not reliant upon domestic purchasing power. In this context, all production costs and overhead are kept to a minimum so as to provide greater competitiveness in the global market. Therefore the informal sector is dominated by sub-contracting relations or small survival type enterprises. The organizational restructuring theory also recognizes the role of criminal

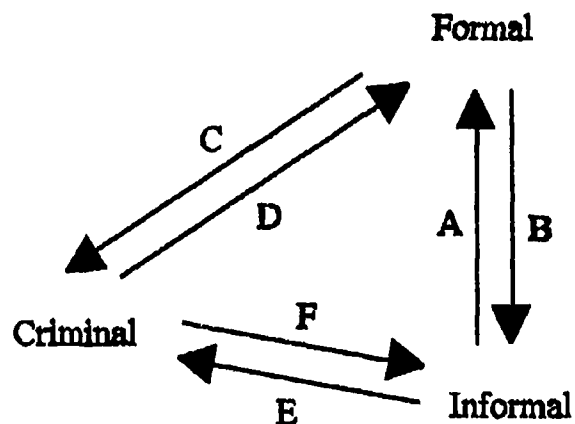
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<sup>24</sup> This term is used in Cartaya, 1987

Figure 2.4

+ = Licit  
- = Illicit

Process of Production and Distribution	Final Product	Economy Type
+	+	Formal
-	+	Informal
+ or -	-	Criminal



- |  |
|--|
| <p>A. State Interference, competition from large firms sources of capital and technology</p> <p>B. Cheaper consumer goods and industrial inputs, flexible reserves of labor</p> <p>C. State interference and disruption, supplies of certain controlled goods</p> <p>D. Corruption, "gatekeeper's rents" for selected state officials</p> <p>E. Capital, demand for goods new income-earning opportunities</p> <p>F. Cheaper goods, flexible reserves of labor</p> |
|--|

Source: Portes, Castells and Benton, 1989 p. 14

activities in the economy and broadens the level of analysis in an attempt to include the global capitalist system. The interaction between the formal, informal and criminal



sectors is shown in Figure 2.4.

The growth of the informal economy throughout the world is explained by the process of organizational decentralization. While blatantly apparent in developing countries, the informal economy is in no way exclusive to developing regions of the world. It exists by other names in the industrialized countries: black economy, underground economy, moonlighting and illegal immigrant labor. Among economic systems in developed countries, the Italian is most commonly cited (see Redclift and Mingione, 1985 and Portes, Castells and Benton, 1989).

Technological advances have altered the production process away from line production toward integrating components produced internationally. Therefore, the vertically integrated business structure and the itinerant costs of reproducing it and the labor force (i.e. overhead and 'indirect' wage expenses), become a competitive disadvantage (Cartaya, 1987 p.83). The reduction of direct or indirect wages in the face of increasing taxation and costs of social programs due to the spread of activities outside the control of the State, requires that people find other sources of employment and income:

"The informal economy is thus not an individual condition but a process of income-generation characterized by one central feature: it is unregulated by the institutions of society, in a legal and social environment in which similar activities are regulated" (Portes, 1978 p.12).

The impact that informal production has on productivity

is less clear. Since the majority of informal sector work in developing countries is completed with rudimentary technology, expansion of the informal sector has reduced the output per worker. However, when advanced technology is applied, productivity may increase, as well as worker satisfaction. Combined with a simultaneous reduction in overhead costs, using informal sector production can increase the profitability of businesses (Portes, Castells and Benton, 1989 p.25).

The role of the State in this restructuring is somewhat ambiguous. Although the informal sector is frequently the target of harassment by some officials, it is more generally tolerated by the state because it represents the most viable form of employment creation and is an increasing source of political legitimation. The continued existence of subcontracting and the maquiladores in Mexico, the SEZ's in China, and the use of illegal immigrant labor in the U.S. all support this claim. Government actions are typically to allocate resources to the informal sector in absence of the will to regain control of the structural problems it poses (ibid 303).

The social implications of the decentralization and globalization of business are detrimental to the working class. Both processes undermine the bargaining position of organized labor and make it increasingly impotent in forming the social and political agendas of the country. Just as

importantly, the move by unions to protect their gains previously won, causes a split in the working class into groups with some degree of protection and some without. This scenario was evident in Canada during strikes at Canada Post and by the Public Service Alliance Canada over the summer of 1991. Fragmentation of the working class renders existing social classes obsolete (Portes, Castells and Benton, 1989 p.309). In this sense, the role of the informal sector in determining the course of society is uncertain because it does not represent a homogeneous social group.

Solutions to the informal sector do not rest in resource transfers, rather they rely on structural change. Particularly important is redefining the relations between the state, business, organized labor and new social actors (i.e. environmental movement, women, ethnic minorities). The existing structures have long supported the privileged class at the expense of the living standards of others. Reassessment of the industrial model of development that has prompted this, as well as developing " a new Social Contract that would guarantee minimum living standards and security to people as people and not as workers ..." (ibid p.310) are necessary to resolve the problem encountered in the informal sector.

#### IV. Analysis

After nearly two decades of use, the term informal sector is still conceived within academic disciplines in different ways. The numerous synonyms by which it is known show that it has different functions for all of them (see OECD, 1990 and Peattie, 1987). What is generally accepted is that the informal sector is the fastest growing segment of the economy and will play a vital role in the economic and political future. However, theoreticians do not conceive the informal sector in remotely the same manner. When the evolutionists analyze the informal sector, their emphasis is on the larger businesses, while the involutionists only consider the smallest, survival type businesses. With these differences, in its current usage, it is best to consider the informal sector as a general term, similar to Agriculture, Industrial or Service, that represents a variety of job types.

The PREALC version of informality is widespread in Latin America because it calls for fundamental restructuring of domestic and international systems, while at the same time allows hope for resource transfer programs. While ambiguity may be pragmatic for a multilateral development institution, dividing the informal sector into three levels: small, micro and survival enterprises is negative factor for

academics for three reasons: a) it implies a continuum exists between the various levels which is not at all apparent; b) it allows successful interventions at one level to indicate progress of the whole, which again is not apparent; and c) it allows economic rationality to be applied to 'survival' activities, which is misleading.

Despite conceptual confusion within the predominant theory of Heterogeneity, it is unlikely that a clearer definition will be arrived at because of the inability of other groups of theories to provide a complete picture. The evolutionary growth theories are overly optimistic, while the involutionary theories are overly pessimistic. Moreover, development agencies, which fund the majority of research, have a political and philosophical belief of the development process that precludes a radical restructuring of the economic and political system at either a national or global level.

Donor agencies were instrumental in bringing the informal sector into focus and distinguishing it as a target for assistance. It is therefore in their interests to put the best light possible on the informal sector so as to show progress in alleviating poverty and thereby perpetuate the existing political and economic structures at all levels. Isolating the survival level would focus attention on the structural inequities. A heterogeneous informal sector allows some masking of these fundamental structural

problems.

Assessment of the assisentialist resource transfer perspective, shows that identification of problems and solutions of unemployment and poverty has not progressed substantially since the RWG period. The concept of the 'missing middle' is exemplary. It is apparent that such a feature exists in developing countries, but studies that advocate support to this area offer little analysis of why it exists. They do not recognize the different economic structures in developing countries, particularly the role of TNC's and oligopoly markets. They also neglect the political structural constraints identified by de Soto.

Although one can justify assistance to larger businesses, a very different type of support is required by the masses of poorly educated and untrained that are the majority of the UIS. Moreover, increasing the size of businesses included in the UIS increases the demand for credit, as opposed to the technical or social promotion services, because larger businesses are generally operated by more knowledgable people. It also inflates key impact measures and thereby exaggerates the benefits of SME programs.

The conviction of the missing middle proponents is so strong that the policies they advocate purposefully exclude the majority of businesses in the UIS. They also ignore solid evidence that refutes their contention that intensive

job creation is most important in developing countries. Two recent studies in Colombia and the Dominican Republic indicate that extensive growth (the creation of new small sized businesses), as opposed to intensive growth, is the most dynamic source of employment in these countries (see Lopez, Corchuelo and Zorro 1990; MSI 1990).

Proponents of the 'missing middle' also disregard the detrimental impact that SAP has had on exactly this group. As will be discussed shortly, restricting credit, devaluing currency and encouraging TNC investment subverts the formation of small domestic industries. Because the evolutionists also promote the ideology of SAP above all other macroeconomic adjustments, their recommended policy changes have very distinct limitations. The issue then becomes the possibility for SAP to promote job creation and poverty alleviation in the informal sector.

The solutions derived from the assistentialist conceptualization of the UIS will be increasingly ineffectual with the degree to which the problems of poverty and unemployment are rooted in the economic and political structures and to the extent which self-employment predominates in the economy.

The neoliberals' attack on domestic economic policy and the political system is valid, but minimizes the impact that external or global forces have on the existence of the informal sector. Based on the increasing integration of the

global economy and the influence that foreign powers have in determining domestic policies of developing countries, the neo-liberal position may give important insights into the local causes of the informal economy, but can not be seriously considered as a full explanation of the informal sector. Because it is only a partial analysis it is an unlikely solution.

The involutionary theories, along with the structural component of the PREALC version, have a greater ability to explain the genesis and perpetuation of the informal sector in developing countries. This is particularly true for the smallest enterprises which form the majority of the informal sector. As this part of the informal sector grows, the involutionary theories increase their relevance over others.

Their focus on the lack of employment creation in the formal sector and the relationship between businesses and their insertion into the economic system has given penetrating insights into the nature of capitalism in developing countries and into the restructuring of businesses and work that is taking place in developed countries also.

However, the involutionists do not provide a complete picture. The neo-marxist approach appears overly-pessimistic about the possibility for accumulation to occur. Evidence does show that very small businesses can grow and that incomes can increase and be higher than those in other



sectors of the economy. For this reason, the functional nature of the informal sector is not certain. Some people deliberately choose to produce informally because of better income, the flexibility that informal employment provides, the opportunity to use learned skills and increased self-esteem. Neo-marxist theory is too rigid to accept these points.

Another criticism of this theory centers on its lack of identifying the specific nature of the relations between the petty commodity producers and the rest of society (Schonwalder, 1991 p.41).

The Organizational Restructuring theory is on the cutting edge in describing the economic malaise in both the developed and developing countries. It also has a strong explanatory power over the social and political contexts of the role of the informal sector in developed and developing countries. It should be valued for its attempt to assess the informal sector from a socio-political rather than economic viewpoint. Raising questions of the whole process of industrialization also puts it in a unique position of challenging conventional thought.

Lack of supporting research to date allows it to describe the flaws in the existing system and only the types of policies necessary to resolve the problems. Hopefully in the next years a more thorough analysis of the configuration of social actors necessary to bring about the required

changes will be put forth, giving the theory a comprehensive constructive side.

#### V. Convergence of the debate

Despite these very different conceptualizations of the informal sector, one key feature of the theories reviewed is that they regard structural change in both the economic and political spheres as a significant part of the solution to the UIS. The difference between the evolutionary and involutory theories is the extent of change. At one end of the continuum, the neo-liberals believe that structural change aimed at freeing up the market is sufficient. The model of development remains untouched. At the other end, the organizational redistribution approach calls for nothing less than reconfiguring basic social relations and changes in the development model. With such consensus between right and left theoreticians, focus must bear on the type of structural change.

Generally, the impetus for structural change comes from either internal or external forces. In the former, groups apply pressure violently or peacefully, legally or illegally, overtly or covertly, on the government in order to dictate the direction of change. In the latter, external institutions or other countries demand or give incentives to governments that make certain reforms by offering access to

needed resources, inputs or markets. The degree to which external forces dictate reforms appears directly related to the political relation with the less powerful country and the scarcity and need of the resource in question.

#### A. Internally Induced Models of Reform

Biggs, Grindle and Snodgrass identify three types of conditions that allow for significant policy change: regime change, authoritarian control, and political engineering. Where the first implies military coup or revolution and the second excessive concentration of decision making or being prone to repressive tactics, the last is seen as the best means of effecting change (Biggs, Grindle and Snodgrass, 1988, p.68-74). The assumptions involved in this categorization are numerous and in the wake of the peaceful revolutions throughout Eastern Europe and the dissolution of the Communist Party in the USSR, other types of change are possible. However, political engineering is a much more likely scenario because of the wave of democratization that is overwhelming the world.

Political engineering is about constructing power blocs that compete to influence policy for their benefit. One must recognize the scarcity of resources of the poor as opposed to the concentration of resources to the wealthy that exists throughout Latin America. It is therefore impossible to speak of political engineering without first addressing

means of mobilizing and organizing the poor so that they can in fact participate in the process. The rise of the concept of 'empowerment'<sup>25</sup> denotes this realization. When the poor are in fact mobilized the outcome can be significantly positive as shown by the Grameen Bank and SEWA. Both programs have secured changes in policy that impact on the entire sector and not just program recipients. Similarly, the history of popular uprising in Colombia has made it one of the most progressive countries in instituting policy towards the urban and rural poor. In 1987, the government implemented policy directly aiding the microentrepreneurs into the National Development Plan. Moreover it has been the politization of M-19 (formerly a left-wing guerrilla movement) that has brought about fundamental change at a constitutional level in favor of the disadvantaged and a relatively peaceful time. These examples show that organization of the poor while difficult, time consuming and generally dangerous has enormous benefits.

Any discussion of retrenching the state in favor of the market before this mobilization and organization has occurred is firmly based in an ideological belief that the market will fairly allocate resources. It is contrary to overwhelming evidence to believe that reliance on the market

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<sup>25</sup> Empowerment is most generally related to a process of education where people being more able to control their destiny through identifying problems and being able to act against them; to have access and control over resources. There are many references to the concept: see Bhatt, 1989; Korten and Klauss, Development Dialogue, 1989.

forces can bring about development as it is considered in modern times. The experiences of Japan, Korea and Taiwan emphatically serve to show that the state plays a vital role in protecting the interests of the small and creating the conditions for development. The debate should not be about whether the state has a role in development, but what role the state must take<sup>26</sup>. In this light the proposals of the neo-liberals are distinctly apolitical and therefore thoroughly insufficient as a development strategy.

#### B. Externally induced models of reform

While governments and citizens do have choices among types of internal models of reform, very few countries today are immune to the trends brought about by the global restructuring of finance, trade and production. Since the onset of the debt crisis and the drying up of commercial sources of lending in the 1980's, every government in Latin America has either signed an IMF adjustment package or has paralleled IMF policy prescriptions after refusing to sign an official agreement. Moreover, for reasons of cross-conditionality and the supreme confidence in free market policies that has emerged in the recent years, the largest donor nations are compelled more than ever to impose market liberalizing SAP's on recipient nations.

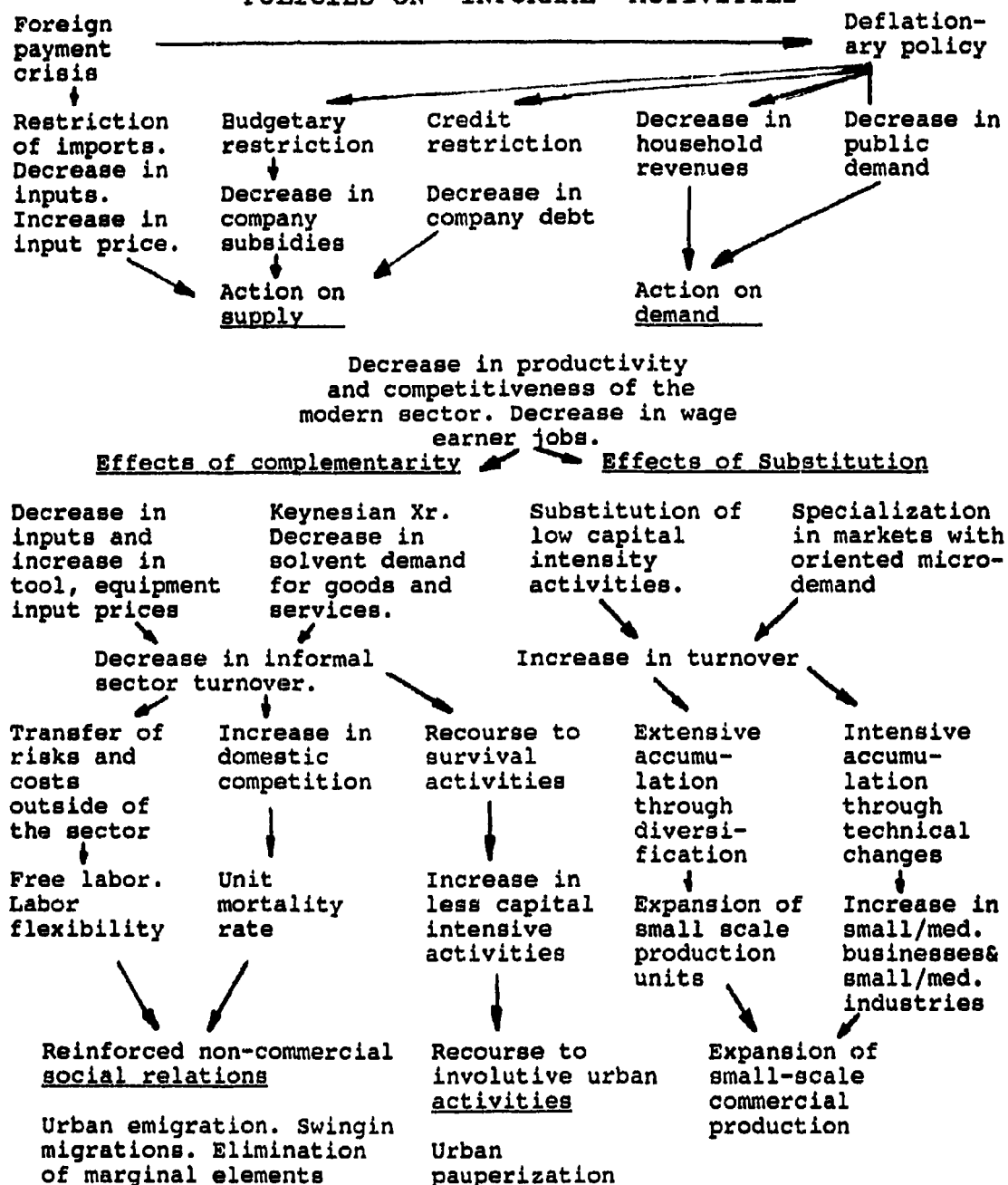
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<sup>26</sup> Dr. Paul Bowles of Department of Economics of St.Mary's University, must be credited with driving this point so forcefully home in numerous discussions and seminars.

SAP's, as promoted by the IMF, are a series of economic policies attempting to bring the short-term balance of payment accounts into equilibrium. The key policies in this regime are credit restriction, currency devaluation, reduced government subsidies and wage controls. In effect SAP's induce a domestic recession by reducing domestic demand in order to maximize revenue generating potential. However, because the typical structure of demand in developing countries has both domestic industry and consumers reliant on imports to meet basic needs, the policy of currency devaluation causes inflation by raising the prices of both imported capital and consumer goods. The impact of these policies on the middle and lower classes is well evidenced by the riots they have sparked in all areas of the world.

The result of re-shaping the macro-economic structure of the country has significant impact on informal activities. Table 2.3 traces out three potential outcomes of adjustment policies on small businesses of the UIS: one route leads to an expansion of the small scale commercial production, one to urban pauperization and one to the expansion of informal relations in their survival, non-market sense. It is not to say that SAP's are the cause of the informal sector. This would be an ahistorical analysis discounting similar activities that existed long ago. It is to say that through inducing a recession, SAP's contribute to expanding the sector by forcing larger businesses and

**Table 2.3 THE EFFECTS OF CRISIS AND ADJUSTMENT POLICIES ON "INFORMAL" ACTIVITIES**



source: Hugon, 1989

educated people into activities characterized as informal. This has a tremendous impact on both the needs of

informal operators and the type of assistance given. Particularly in reference to larger businesses, SAP's increase the demand for alternative credit sources within the society and in this way create the demand for scaled-up SME programs.

## VI. Conclusion on structural change and the UIS

The type of structural change promoted within developing countries is significant. Because SAP's are backed by the industrialized nations, many developing country governments and the major multilateral aid agencies, the externally induced model of reform dominates the practical application of structural change. SAP's continue the program of global integration and orthodox development strategies and thereby perpetuate the existing political and economic structures at both a national and international level.

While SAP's are backed by the international community, national governments willingly implement SAP's because they support the underpinning ideology of private enterprise, open markets and free trade as the driving forces of industrial development. However, it is also important to note that access to investment capital or international development assistance is contingent upon the implementation of SAP's. Rejection of the ideology of SAP means



ostracization from the international community as seen by the treatment of Peru and Nicaragua in the 1980's. The detrimental impact that this isolation has on the domestic economy holds great sway with the electorate and provides a powerful political advantage for SAP ideology. In either case, SAP or international ostracization the poor suffer greatly.

At the moment there is no officially acceptable alternative to SAP at either the domestic or international level. Given the relation between the political and economic strategies, this means that the wave of liberal democracy sweeping over the world has little to do with political pluralism and more to do with domination of certain beliefs about the strategy of development. For this reason, there is scepticism about the redemocratization taking place in developing countries. It is not clear that the electorate does in fact have the capacity to determine the course of their society. Rather, democracy in Latin America has on many occasions been a facade used to legitimize dictatorships or to maintain puppet governments of Washington. If democracy's second coming, is to distance itself from this legacy, it must be confident enough to allow a full range of discussion and it must allow the will of the majority to dictate policy.

Focusing on the political-economy of macro-economic policies allows a rationalization of resource transfer

programs brought forth by the multilateral and donor agencies in regards to Latin America. The actions of donor agencies is a reaction to the detrimental impact of SAP. With the induced recession of SAP impoverishing the people, destroying the small and medium sized businesses, the infrastructure and the governments' ability to act otherwise, it is necessary for the international community to provide seed money which will support what remains economically viable as a means to ameliorate discontent. In this sense scaling-up SME programs can be seen as a parallel intervention to SAP primarily concerned with preventing further erosion of the domestic economy, rather than with job creation and poverty alleviation.

In the wake of the peaceful revolutions of Eastern Europe, internally induced models of reform, as listed above, need to be reassessed. However, for the purposes of this study political engineering is seen as the most viable and likely method to internally induced structural change.

The poverty and unemployment in the UIS needs to be attacked through political mobilization of the poor and powerless in order to open room for discussing alternatives to SAP. Alternative policies to SAP do exist, however they are outside of the present regime of global integration and conventional economic wisdom. Because political mobilization and de-linking can not be achieved under a SAP regime, a key assumption of this thesis is that internally induced models

of reform based on true pluralist democracy is a necessary condition for resolution to the structural problems in the developing world.

### **Chapter 3. Small and microenterprise programs: from conception to scaling-up.**

#### **I. Introduction**

Private sector led SME programs are now a common item on the menu of Latin American countries development efforts. It is no longer so interesting to start a program: one US based Private Voluntary Organization (PVO), ACCION International, is involved with 50 programs in 12 countries and there are many other organizations working in the SME sector<sup>1</sup>. The state-of-the-art discussions are about scaling-up the existing programs to reach a significant number of the target population. However, because scaling-up is a function of the success of smaller programs, the first part of this chapter will review the development of SME program methodology and evaluation. The second part will discuss specifically the scaling-up process.

In both the SME and the scaled-up programs, there are two main factors of any intervention that need to be separated and discussed. The first is the program components; who are the beneficiaries, what types of services are necessary and how is the impact of different services measured. The second, is institutional factors that

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<sup>1</sup> This is in no way meant to trivialize the difficulties of operating programs. SME programs are difficult to do well. For this reason Tendler states that the best performing programs are those that start simply (Tendler, 1987). It is only meant to point to the numerous organizations such as National Development Foundations in many Caribbean countries, The Calmeadow Foundation, Mennonite Economic Development Agency (MEDA), OEF/International, Appropriate Technology International, CARE and others operate SME programs.

determine the organizations' ability to provide services.

## II. SME Program Components

There are three basic components of SME programs: credit, technical and training services and social promotion. It is the weight which each component is given which fundamentally alters the programs' orientation.

### A. Credit

Space for the private sector to implement credit delivery programs developed due to the failure of the banking system and the failure of government credit programs to deliver this service to the smaller entities of society. Generally informal sector businesses are not able to access loans offered through the private banking system for a number of reasons: the small size of the loan needed makes it unprofitable for the private institution; SME operators generally lack sufficient collateral; the length of time between application and disbursement of loan is inconvenient for the informal operator; the loan application procedure is too time consuming and complex; and ceilings on interest rates discriminate against small businesses (Jackelen in Levitsky, 1989, p.133).

Government initiatives designed to bring credit to this sector have existed for many years in the form of

development banks, loan discounting funds or loan guaranteed funds. These sources have provided significant credit, but they have had a history of becoming funding sources for medium or small size businesses and thereby leave out most informal operators (Blayney and Otero, 1984 p.4). In general, offering credit at subsidized rates attracts untargeted larger businesses. Also the methodology of these organizations has been highly bureaucratic and susceptible to political influence.

An alternative source of financing is the money-lender, but they charge a usurious rate of interest<sup>2</sup>. Beginning in the late 1970's, local NGO's and international PVO's started to experiment with offering credit at rates which reflect the real cost of providing the service while also undercutting the money lender (See Tendler, 1983). It is therefore apparent that offering credit through the NGO sector to the UIS is a relatively new intervention. The success of NGO's at delivering this service, relative to previous attempts, has caused programs to proliferate. They have also served as a powerful example of the efficiency of the private sector in developing programs where governments have consistently failed. In this way, NGO programs have boosted the movement that began in the 1980's which argues

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<sup>2</sup> There are a number of other sources from which start-up or expansion capital can be obtained: family, remittances and savings. These are very important sources of funds because they are generally provided without interest and are frequently one's first choice. It is their availability and size that are generally the greatest limitations.

for an increased role of the private sector in the development process.

#### B. Technical and training services

Because programs target the poor, access to credit alone is not sufficient to ensure growth or continuity of a business. There are fundamental issues of management and training that also must be addressed. This is evident from surveys of microenterprise operators in both Colombia and Honduras. In the former, in 1984-85, 12.4 percent of microentrepreneurs asked for credit as opposed to 61 percent requesting accounting assistance. In the latter, 90.8 percent of respondents thought that credit and training were essential services of aid programs (Lautier, 198 p.282; Olivares, 1989 p.15). The need for services other than credit is also emphasized in the conclusion of the Stocktaking study<sup>3</sup>:

"The services provided by nontransformational minimalist credit programs are sufficient to generate benefits for some microenterprises, in some areas, at some stages in their life cycle. But the needs of the vast majority of microenterprises cannot be satisfied merely by providing small working capital loans" (Boomgard, 1989 p.66).

For this reason, non-financial services are an important part of program methodology. At the lower stratas, most

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<sup>3</sup> U.S.A.I.D. Evaluation Special Study No.65, 1989, is also known as the Stocktaking Study. It reviews A.I.D.'s support of past projects and points to future directions of support.

people working in this sector lack the knowledge or confidence to use techniques that can allow them to control costs or quality, or to plan a strategy. Technical assistance may also include identifying markets and securing improved productive technologies (Blayney and Otero 1985 p.64).

### C. Social promotion

Interventions aimed at the UIS have social objectives as well because a common feature of poverty throughout the world is political powerlessness. Poverty is not only the lack of access to material goods and services provided by a society, it is also a function of the lack of ability to influence public policy. For this reason the poor are referred to as being 'invisible' and in this sense, poverty has both an economic and political source (see Development Dialogue, 1989 vol.1). In order to address this powerlessness, organizations can act as an advocate for the poor or take an active role in organizing the poor. In reference to the first, it is clearly expressed in the mission statement of the *Asociacion para el Desarrollo de las Microempresas, Inc.* (ADEMI):

"to serve as a bridge of contact and communication between the business community, the news media, the Central Government and its institutions and the lowest sectors of society and to work to elevate the living standard of the last"(ADEMI Mission Statement).

The clearest example of the latter is the Grameen Bank of



Bangladesh which actively encourages the poor to investigate the reality of their circumstances and seek solutions through political pressure (see Yunus, in Levitsky, 1989).

### III. Institutional Structures

The PISCES study<sup>4</sup> concluded that successful programs throughout the world have some common institutional features: good leadership, a motivated and well-trained staff, the need to shape the program to the clients' needs, a community based mechanism for selection, work efficiently to reach a reasonable number of clients without undue delay, are serious about client commitment and improved business performance, remain flexible and willing to change to meet client needs, are concerned with efficient administration, and avoid paternalism and excessive formality (Ashe vol.1, 1985 p.13-16). In identifying these characteristics, NGO programs assumed right from the conception phase, a radically different form of assistance than their failed predecessors (see Table 3.1). Moreover, because the expansion of a program is a continuum, the importance of

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<sup>4</sup> The first study of the impact and methodology of microenterprise programs was carried out from 1979-1985 by the PISCES (Program for Investment in the Small Capital Enterprise Sector) project. With funding from the Employment and Enterprise Development Division of the Office of Rural and Institutional Development of USAID, the first stage of the project was to analyze existing programs in sixteen countries in order to assess which aspects contributed to the success of a program and which to its detriment. The second stage was to test the conclusions by designing four study projects based on the successful characteristics and evaluate their impact. ADEMI was one such program.

adopting the proper institutional vision from the beginning is paramount (Otero, 1989).

The key feature of the shift in conceptual focus is the

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Table 3.1

Conceptual Focus of Micro-enterprise Programs

Traditional Model	Non-Traditional Model
<ul style="list-style-type: none"><li>* the micro-entrepreneur's primary need is technical assistance (general training in accounting, pricing, marketing, etc.)</li><li>* the micro-entrepreneur does not know how to use credit.</li><li>* institution applies subsidized negative interest rate.</li><li>* institution depends on donations and subsidies from internal and external sources. Transmits this dependence to its beneficiaries.</li><li>* institution reaches limited number of beneficiaries.</li><li>* institution covers a wide scope of projects, offering different kinds of services.</li><li>* institution provides much assistance to clients.</li><li>* institutional dependency on subsidies and donations limits the program life.</li></ul>	<ul style="list-style-type: none"><li>* the micro-entrepreneur's primary need is credit.</li><li>* the micro-entrepreneur knows how to use credit provided it is in the amounts and terms to which she or he is accustomed</li><li>* institution charges positive interest rate. No subsidies.</li><li>* institution believes it can be self-sustaining through its own growth.</li><li>* institution reaches large number of beneficiaries. Wide outreach.</li><li>* institution specializes in projects with very specific services.</li><li>* institution does not want to create dependence. Follows an approach of supporting individual initiative.</li><li>* institution works to be self-sufficient.</li></ul>

Source: Executive Summary of the Association for the Development of Micro-enterprises Inc. (ADEMI) Jan. 1991

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outlook toward institutional sustainability and self-sufficiency. Where self-sufficiency is not an issue in the Traditional, it is of primary consideration in the Non-Traditional. This contrast is to be expected with the shift of programs to private sector operators. This shift also reflects the interests of donor agencies, whose aid flows came under greater scrutiny due to the rise of conservatism and a global recession in the 1980's (see Morgan, 1990).

Two terms arose in the vocabulary of donor agencies during the last decade that hint at a new formula for development assistance: 'self-help' and 'self-sufficiency'. 'Self-help' means that people in developing countries have to take a greater responsibility for bettering their own lives. 'Self-sufficiency', the institutional equivalent, suggests that organizations have to be more responsible in covering their expenses<sup>5</sup>.

In essence, self-sufficiency injects an institutional tension into the non-profit sector that has been frequently criticized for its sloppy management. Self-sufficiency requires that NGO's remove themselves from their historic role as the world's social workers and take on a more business-like approach to development work. It necessitates

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<sup>5</sup> Monitoring organizational performance is as vital as the impact of the SME program on its clients. After the PISCES study, USAID's phase 2 program, named ARIES (Assistance to Resource Institutions for Enterprise Support), was specifically designed to strengthen organizations and instill in them a new professionalism (see Mann, Grindle and Shipton 1989). Similarly, the third phase, GEMINI (Growth with Equity through Microenterprise Investments) is specifically charged with institution building in developing countries.

a high level of institutional efficiency, tight accounting and control procedures, and clearly defined program objectives and measurement criteria. A more indepth discussion of the concept and its implications on program design follows.

#### A. Program Models

Within the Non-traditional focus a variety of SME programs exist. To reflect the different mixes of the three essential program components, Table 3.2 distinguishes the models used in Latin America and those already scaled-up programs existing elsewhere. Omitted from this table are programs that offer only training.

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**Table 3.2** Selected Small and Micro-enterprise Assistance Models and Examples of Programs that Utilize Them

Model 1	Individual Financial Assistance			
Model 2	Integrated Financial Assistance and Technical Assistance/Social promotion			
Model 3	Integrate and Sequenced Financial Assistance, Technical Assistance and Training for Individuals			
Model 4	Integrated and Sequenced Training, Technical Assistance and Financial Assistance for Individuals			
Model 5	Group Oriented Social Promotion, Financial Assistance			

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1	2	Models 3	4	5
ADEMI+ BKK*	ADOPEM+ ADEPE BANCOSOL* ACP AGS*	UNO ASEPADE	FDD+ Carvajal NDF	MUDE+ IDDI+ Grameen* PRODEME

\* refers to programs reaching over 10,000 clients

+ programs in the Dominican Republic

Source: elaborated from Mann, Grindle and Shipton, 1989 p.58

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At one extreme is the individual financial assistance model, commonly referred to as minimalist credit because of its emphasis on credit delivery. Its basic premise is that credit is the most substantial barrier in aiding the poor. At the other extreme is the group oriented social promotion and financial assistance model, which takes a holistic view of poverty alleviation. These programs offer health, education and community organization information, as well as credit and technical assistance.

#### B. Program design

The Stocktaking study identified three types of SME programs: enterprise formation, enterprise expansion and enterprise transformation. Where the program model represents the mix of credit and services provided, the program design largely relates to the type of clientele that the program wants to reach.

**Enterprise formation** programs are aimed at the poorest individuals and/or the smallest scale of operation. They target what is referred to as the "survival economy" within the informal sector. Program objectives are wider in that they must provide more services to start-up activities to the least experienced, least educated and generally least represented of the population. They are associated with integrated community development programs because they are frequently involved in social advocacy. Programs of this

nature are identified by the component mix of Model 5.

**Enterprise expansion** programs work with improving existing businesses and have evolved into minimalist credit interventions. They can work in either an individual or solidarity group methodology with micro or small businesses. Loans tend to provide short-term working capital and the benefits are measured in both income growth and decreased underemployment. This corresponds to Model 1 & 2.

**Enterprise transformation** programs orient interventions towards the largest businesses characterized as informal in hope of graduating them from the informal sector. Loans are larger and can be used for fixed capital. Because firms are larger, the importance of employment generation is a key project benefit. Models 3 & 4. (Boomgard, 1989).

#### C. Credit and Service Delivery methodologies

While there are five program models represented by three program designs, there are only two delivery mechanisms used: solidarity group and individual.

##### 1. Solidarity Groups

The solidarity group methodology first appeared in the Latin American context in El Salvador in a program operated by PRIDECO/FEDECCREDITO. It is now used exclusively by such programs as the AGS in Colombia, Progreso in Peru and MUDE in the Dominican Republic. Its use has expanded throughout

the region and in nominal terms serves the largest number of clients. Solidarity groups are used in both enterprise formation and expansion designs and in fact are virtually synonymous with service delivery to the microenterprise and survival segments of the UIS.

Solidarity groups are normally made of five to eight individuals involved in similar activities, of similar size and in close geographic proximity. From a program management perspective, the solidarity group methodology lowers costs by transferring certain expenses to the clients. Because groups are self-forming, the program reduces the cost of program recruitment, selection and advertising. It also reduces the cost and complexity of administering the distribution and collection of loans and facilitates the training process. Another key aspect of the solidarity group methodology is that it utilizes peer pressure instead of requiring collateral to ensure repayment. If an individual defaults the whole group is penalized and will not receive another loan until the balance is repaid. Therefore, to a large extent, the cost of monitoring individuals is also transferred to the clients (see Otero, 1986).

Training in these programs normally takes place both before and during the loan period (see Calmeadow Foundation, 1988). Prior to receiving a loan, a group or number of groups will be introduced to the expectations of the program and basic features of saving and management. During the loan

period, courses may be offered or training can be more demand driven. The program design will be the deciding factor.

The benefits of solidarity groups are not solely for the program. In financial terms, the clients can reduce costs by purchasing inputs in bulk and they can obtain better prices by marketing together. The solidarity group can also provide an outlet for social organization and structural change. The examples of the Grameen Bank, the Self-Employed Women's Association (SEWA) and the Working Women's Forum (WWF), all from South Asia, show the potential impact the poor can have on policy when organized through solidarity groups (see Wignaraja, 1990). In Latin America, the Tricicleros of Santo Domingo mobilized around their experiences which they shared initially in a solidarity group program to organize a union to address their concerns beyond their employment (see Reichmann, 1984). The solidarity group therefore provides a unique context of sharing experiences and working towards common goals that does not exist in other methodologies. To this extent 'empowerment', is a by-product of this methodology<sup>6</sup>.

## 2. Individual Businesses

The other type of intervention used in programs is the

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<sup>6</sup> In this case empowerment is defined as the ability to take concerted action against commonly identified problems.



provision of services to individual businesses. Individual lending programs target larger businesses in the expansion and transformation categories. Because the clients operate a larger business and are generally more experienced at managing a business, or require specialized attention, this service delivery approach is better suited to their needs.

The individual business methodology, implies a fundamental shift away from reaching the poorest of the poor directly with services by favoring larger loans to production activities over commerce and services. ADEMI in the Dominican Republic became the prototype minimalist organization specializing in individual lending in the mid-1980's. Today it is considered one of the most successful SME programs in Latin America not only because it is a relatively large program, reaching nearly 6,000 clients, but also because it is Level 3 self-sufficient (this concept will be explained later). The strategy stated by ADEMI and advocated by USAID and the IDB is to support businesses that have the greatest potential to create employment. This refers to intensive growth of businesses and is clearly stated in the mission statement signed by the Internal Executive Committee in February, 1991.

"We think there are fundamental differences between a program with 20,000 microbusinesses with limited markets and another with 5,000 transformation microenterprises that can generate 50,000 jobs directly. Which of the two support better the economy of the country?"

Training programs for individuals are normally provided on a demand driven, one-to-one basis between the program field officer and client during regular field monitoring. Training expenses at ADEMI in 1990 (outside of the salaries paid to its field officers) amounted to 1.5 percent of total organizational expenditures (ADEMI 1991a p.28). This demonstrates the virtual non-existence of training courses. In this way too, the individual approach is inadequate for the poor because people are not brought new information through training. Rather, learning takes place in the context of improving existing knowledge or access to information. In general this means that people are less likely to break out of traditional occupations or roles.

Social benefits are a much less tangible result of individual programs but are said to exist in that they are functional to rising income levels (Blayney and Otero, 1985; Boomgard, 1989 p.18).

#### IV. Impacts of programs

Measuring the impact of different program designs is a difficult process. Figure 3.1 shows a comparison of selected statistics of some programs with different designs. These figures clearly show that expansion programs are reaching a large number of clients at a lower cost than the other two designs (refer to: the number of beneficiaries and column

Figure 3.1 Comparison of Different Models in Selected Countries and Indicators

Country	Program	Type of Program	Year	Years operating	Beneficiaries		Avg. loan size	Characteristics								
					total	per year		1	2	3	4	5	6	7	8	9
Costa Rica	OEF	Formation	1988	2	161	81	721	47	na	45	22	-14	1	100	1164	6
Bangladesh	WEDP	Formation	1988	6	8,919	1,321	60	87	50	25	35	5	0	50	133	1
Avg. Formation Approach (A)				3.7	1,845	328	508	54	25	43	24	3	1	59	948	3
Dorn. Rep.	ADEMI	Expansion	1988	7	19,428	3,428	510	89	6	0	10	74	1	36	na	0
	ADOPEM	Expansion	1991	9	4,270	2,000	255	na	na	na	na	68	na	100	na	157
Bolivia	PRODEM	Expansion	1990	6	14,837	8,645	221	34	0	26	0	53	na	71	na	277
Colombia	AGS	Expansion	1990	5	23,287	na	170	35	20	61	7	na	na	55	na	94
Avg. Expansion Approach (B)				4	161,730	87,871	705	40	30	1	17	23	1	42	575	0
Jamaica	NDF-J	Transform.	1987	5	1,202	240	2,181	44	na	20	15	0	3	35	960	0
Colom.(D)	Carvajal	Transform.	1988		10,239	1,765	1,150	na	na	na	11	na	na	na	na	1
Avg. Transformation Approach				2.3	603	264	3,261	63	45	28	18	0	10	27	2549	1

## Note:

- 1) % of loans to manufacturing enterprises
- 2) % loans used for fixed capital
- 3) New enterprises as % of total beneficiaries
- 4) % loan fund in arrears
- 5) Real interest rate
- 6) Avg loan size/GDP per capita(1985)
- 7) % women beneficiaries
- 8) life-of-project cost per beneficiary
- 9) latest cost per dollar loaned
- na not available

A) average figures from Boomgard 1989 which includes programs not shown

B) this includes BKK Indonesia which has over 2,700,000 clients

C) self-sufficiency measures

D) these figures are for all Colombian projects using the Carvajal approach

Source: Boomgard, 1989, Stearns and Otero, 1990, ACCION pamphlets 1991



8). The average numbers are distorted in favor of the expansion programs because of the inclusion of BKK Indonesia, but even without it, the overall results would be only less dramatic.

This result is not unexpected. Expansion design programs are created for cost efficiency by minimizing non-revenue generating services and emphasizing institutional efficiency. Therefore the expansion design lends itself to the objective measurement of economic analysis, whereas the other two rely on benefits that are less tangible: training and social. The inability to quantify the value of these latter two program components in the standard cost/benefit analysis has led to an emphasis on the expansion methodology in the scaling-up effort. This situation exposes the weakness of the existing evaluation criteria and techniques. Examples of bias in the evaluation criteria of all three component parts and institutional success towards the expansion design are discussed below.

#### A. The Impact of Credit

The impact of credit is normally measured by increases in both business income and the number of jobs created and strengthened. It is also assumed that increases in the income of a business or employee will be indirectly beneficial for family members. The problem with relating income increases to the receipt of credit is that credit is

only one variable that can lead to rising income and it is very difficult to isolate from others such as: greater demand in the economy, reduced costs, better marketing and others. This is even more true with microentrepreneurs, who are notorious for not keeping accurate records. Moreover, the assumption that family income increases with business income seems unjustifiable. One in-depth study in Colombia found that the impact of credit on family income can be beneficial, neutral or negative depending on the type of business operated (Lopez, Corchuelo, Zorro, 1990 p.54). Therefore it is simplistic to equate rises in income exclusively with credit delivery and that the family automatically gains from access to credit.

Using jobs created to measure impact, assumes that the objective of the business is to grow and create employment. This capitalist concept of business operation does not apply to the subsistence economy. The distinction of the survival level and the micro- and small businesses within the informal sector is based on the fact that increased income at the lowest level is used for consumption rather than reinvestment. Furthermore, at the microenterprise level, many people do not want to expand the business beyond the family size. Therefore at this level also, creating employment may not be an objective (see Tendler, 1983 and Stearns, 1989).

The jobs strengthened criterion is similarly biased

towards larger businesses because it is simply a head count of the number of workers that are employed by a business at the time a loan is received. For this reason, when the upper limit of the UIS increases, as in the case of USAID between 1985 and 1991, and loans to larger businesses are made, impact evaluation figures in this category rise automatically. Impact evaluators also assume that jobs are somehow more secure after a loan is received. Considering that businesses need to have operated for a period varying from six months to a year before they can apply to most programs, the quality of this criteria is highly suspect.

#### B. Impact of training

The impact of training is a much debated topic<sup>6</sup>. In essence, the problem of evaluation resides in how to measure the benefits accrued from training. For the individual, the effectiveness of training is normally measured according to the increase in business income. However, as seen with the case of credit, it is virtually impossible to isolate a single variable's impact on increased income. On a societal basis, the benefits of training is not tangible because it is geared towards increasing the business income of individuals.

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<sup>6</sup> An extensive literature on training in the informal sector has been published by the ILO and is incorporated in many important books, see Nelson, 1980; Loucks, 1988; Levitsky, 1989; Buvinic and Berger, 1989 and Fluitman, 1989.

With the direct impact of training difficult to assess, standard cost/benefit analysis produces results biased against programs that offer training programs because training is a non-revenue generating service and is expensive. Even when costs are passed on to users, training programs rarely are able to cover all expenses incurred. Training programs are also difficult to do well. They rely on the effective exchange of relevant information between trainers and trainees. Other significant problems to be surmounted by training programs are where and when courses are offered, and frequent difficulties with basic levels of literacy or numeracy among clients (Duran, 1990). The ambiguous result of training programs and their expense and cost in time and energy, makes program designs which offer training courses far less cost effective than those that do not.

Despite these problems it is known that training is required by large segments of the informal sector. Training makes a clear contribution to programs when: it serves to increase the efficiency of the credit mechanism; is tailored to immediate business needs; is offered by knowledgeable and motivated trainers; and is carried out within a system that allows for beneficiary feedback (McKean and Binnendijk, 1988, p.12). Its utility can be measured by monitoring whether people use the skills through training and/ or



fact that people attend courses, pay for them and/or request that programs offer courses, demonstrates the utility which people see in training. In this sense it is interesting to note that Regino found that one criticism that clients of ADEMI had about the organization was that it did not offer training programs<sup>8</sup>.

### C. Social Impacts

The measure of social impact is even more intangible than training in that it deals with self-esteem; the benefit of learning by doing; increased social awareness; and taking collective action even if the specific goal is not attained. Social impact attempts to deal with issues of human and social development whose measurement exists outside of the paradigm that guides decision-makers and donor agencies today.

The assumption that evaluators make when they consider social benefits the function of increased income relies entirely on the materialist view of society and completely ignores the political nature of poverty. It allows programs that make loans to larger capitalist oriented businesses claim the greatest results. However, as Wignaraja writes:

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<sup>8</sup> Overall 13% of the clients surveyed wanted ADEMI to offer courses on production and administration.

"Individuals cannot address the problem of their powerlessness; this can only be done through collective action,... the provision of credit in the absence of this organization is not developmental, but further erodes self-respect, dignity and collective action and leads to depletion of even the resources and assets already available to poor women" (Wignaraja 1990, p.81).

Furthermore, the assumption that all family members benefit from increased business income is more of a moral wish than a fact grounded in reality.

The varied use of the solidarity group methodology between Latin America and South Asia SME programs emphasizes the different conception of social impact. South Asian programs such as the Grameen Bank, SEWA and the WWF, use solidarity groups to reach larger numbers of poor people but also as a tool to engage in empowering activities such as community meetings, encouraging investigation and action on common problems. These programs take a leading role in advocating policy change to government institutions that can implement resolutions to problems affecting the poor. Through the solidarity group, the poor learn to organize and participate in the construction of their society on a daily basis. This is the basis of political engineering.

Latin American programs on the other hand have typically not played this role. The case of the tricicleros is exemplary (see Reichmann, 1984). When the union began focusing on social objectives or benefits that were non-revenue generating, the program refused to make more loans

to the union. The program's mandate made it unable to respond to the initiatives of the clients because its own existence was based on demonstrating benefits that can be recorded on a balance sheet: jobs created and strengthened, and percent self-sufficiency.

The function of the solidarity group generally differs between South Asian and Latin American programs. In the former, it is the focal point of participatory investigation and learning which provides the means to expand income generating programs into completely integrated development efforts impacting economic and political structures. In Latin America, while some holistic programs exist, the solidarity group is generally used to reach the poor, but only in the context of distributing and collecting loans. It serves a strictly economic objective. What ever benefits that inherently flow from organizing the poor are claimed as social benefits of the program but there is no intention to expand the scope of these benefits<sup>9</sup>.

#### D. Institutional Measurements

To judge the efficiency of organizations and program designs, the criteria generally used is the level of self-sufficiency. As indicated in Table 3.3, there are five levels of self-sufficiency that are determined according to

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<sup>9</sup> Otero, 1989, shows that while 100 percent of clients of ASEPADE in Honduras surveyed said they would like to involved in a National Association of Microentrepreneurs, only 60 percent actually were.

the types of program costs included.

The rationalization to achieve a high level of self-sufficiency is that it allows programs to become independent from donor agencies. However, independence is a paradoxical goal because donor agencies offer subsidized loans which are used to capitalize SME programs<sup>10</sup>. More than half of the funds earmarked for FONDOMICRO are at concessionary rates (USAID, 1990 p.42). Therefore, the self-sufficiency percentages above the Solvency level are inflated because the cost of capital does not reflect the real cost of money

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<sup>10</sup> The Inter-american Development Bank estimates that it will make available \$500 million over five years to fund small business development programs. USAID small enterprise development fund equals \$75 million. The Inter-American Foundation contributed \$4.5 million to enterprise development programs in 1988.

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Table 3.3 Measures of Self-Sufficiency

**Level 0: Solvency.**

$$\frac{\text{Total income}}{\text{Non-financial operational expenses}} = \%$$

**Level 1: Operational Self-sufficiency.**

$$\frac{\text{Total income}}{\text{operational expenses + cost of capital}}$$

**Level 2: Short term Financial Self-sufficiency.**

$$\frac{\text{Total income}}{\text{operational + cost of capital + reserve}}$$

**Level 3: Long term Financial Self-sufficiency**

$$\frac{\text{Total income}}{\text{operational + cost of capital + reserve + capital base inflation}}$$

**Level 4: Institutional Self-Sufficiency**

$$\frac{\text{Total income}}{\text{Level 3 + technical assistance}}$$

note: all expenses directly associated with training would also be added to the denominator

Source: MEDA, 1991b p.36-37

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in the society.

As an evaluation tool, self-sufficiency criterion is biased towards the minimalist model because it is a tool of simple cost accounting. It does not consider that different designs will have different cost structures and therefore have varying success at attaining high levels of self-sufficiency. The provision of non-revenue generating

services by the formation and transformation programs means that a well-managed minimalist program will attain a higher level of self-sufficiency than a well-managed formation or transformation program of the same size, because it has fewer costs. However, the self-sufficiency levels give no indication of the utility of the program to the clients and its benefits to the development of the society or the economy. Decisions based on self-sufficiency figures alone will force programs to abandon non-revenue generating services or eliminate funding to programs that offer them.

The goal of self-sufficiency, whether conceived internally or imposed from outside the organization, will impact on the nature of the program. Self-sufficiency will make programs more selective in choosing their clientele and make them less risk-adverse in the type of client they choose to support. Self-sufficiency also limits the ability of programs to act in an advocacy role: "The search for self-sufficiency may mean that a program lacks the resources to provide meaningful support to the beneficiaries' organizing efforts" (Olivares, 1989 p.12).

Finally, it is relevant to note that no program has reached level 4: Institutional Self-sufficiency. ADEMI's figure of 149 percent self-sufficiency in its 1990 Annual Report indicates level 3 or Long-Term Self-sufficiency. The financial reports do not indicate technical assistance costs, but with a full-time assessor from the GTZ, the IDB,

Peace Corps and Japanese Development volunteers all working in the program, it is reasonable to assume the costs are significant.

With institutional self-sufficiency being out of reach of successful programs like ADEMI, it is an unrealistic expectation of lesser programs. This fact means that some level of subsidy exists in all programs. It is therefore more useful to refer to 'sustainability', the ability of organizations to secure reliable sources of funding for the maintenance of the program (MEDA, 1991b p.31).

#### V. Towards an evaluation framework

The commonly used methods of evaluation are unable to capture the impact that training and social benefits have upon program beneficiaries. This is a serious problem because of the fact that all programs rely on subsidies from donor agencies and therefore must justify future support according to past achievements. Without being able to fully translate the impact of the non-revenue generating components of the program, these components are the first to be eliminated in tough times. Moreover, new programs that are started with donor support are likely to be done in a fashion that makes their progress quantifiable. The first agenda of researchers should be to find ways to resolve this problem.

The evaluation of SME programs must be done according to the objectives that they set. Comparative evaluation without distinguishing between the different program designs is problematic because of the bias of the criteria used. This is detrimental to UIS assistance because funding becomes concentrated in one type of program design and hence one segment of overall target group.

Evaluations should therefore be done on an intra-design basis with efficient programs setting the standards which other similarly designed programs try to achieve. Analysis in this manner would set minimum standards for each type of program design while allowing for different achievement standards between program designs. Such a system would recognize that each program design significantly contributes to development of the UIS by reaching a specific clientele with the type of assistance required to do so properly.

## VI. Scaling-up

The scaling-up of SME programs in Latin America is being done under the impetus of the IDB, USAID, ACCION International and the Calmeadow Foundation. This is evidenced by the commitment of large amounts of funding and technical assistance being offered by these institutions. The purpose of scaling-up is to allow programs to reach a significant number of people as well as establish links with



the commercial banking sector. While this is considered a positive step in the evolution of programs, the idea of scaling-up must also be seen as a result of certain failures of SME programs.

The strongest criticisms of assistance efforts have been that even relatively large programs reach only a tiny percentage of the total potential client base (see Table 3.4). The 'percentage reached' category is not really an

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Table 3.4 Large scale SME programs

Program	No. of clients	Size of SME Sector	% reached	Lending portfolio Million US\$
<u>L.A.</u>				
ADEMI	6,824a	145,000c	4.7	1.5a
PRODEM	14,837b	1,000,000d	1.4	2.4b
AGS	23,287b	623,000e	3.7	2.9b
<u>Asia</u>				
Grameen	339,000f	na	na	50.5f
Sewa	21,000f	na	na	na
BKK	2,700,000	na	na	na

sources:

a ADEMI executive summary Dec.1990

b) ACCION country profiles Dec.1990

c) MSI, 1989. National figures. Refers only to microenterprises

d) Bancosol project paper 1991. Urban and rural

e) Lopez, Corchuelo, Zorro, 1984. Includes only the 4 largest cities

f) Wignaraja, 1990.

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accurate portrayal of the demand for credit or services because it assumes that every one in the UIS is a potential client. Evidence shows that in fact many people do not want or need loans. The MSI survey found that 40 percent of those

surveyed had sufficient access to money (MSI 1989, p.12). While this will temper demand somewhat, there is still a large demand to be met.

Scaling-up must also be seen as a failure of the objective of client graduation (see Stearns, 1989). Programs were supposed to serve as an incubator for informal businesses, which upon reaching a critical mass, would be passed on to formal sector financial and training institutions. In practice this has not happened to any significant degree. In 1989, a survey of ten programs in Latin America found the graduation rate to be 1.8 percent. A conclusion reached by this study portrayed client graduation as a "myth" (Stearns, 1989 p.2).

The reasons for this failure are numerous and implicate every level of participant: the individuals, the SME programs and the banking sector. For an operator, despite the advantages of lower interest rates and longer term loans, the time and reporting requirements of formal institutions are considered excessive. Also, as earlier mentioned, the operator may not be interested in growing the business to that critical mass. Secondly, client graduation may not be in the interest of programs as their stability is jeopardized by constantly replacing the most secure and profitable loans with riskier ones. And finally, there are few if any compelling reasons for formal institutions to get involved in lending to this sector. Microenterprise lending

represents a small fraction of their portfolios and it is still a relatively time consuming and unprofitable activity especially in the context of credit restrictions. (Stearns, 1989 p.28-29).

With graduating clients no longer an achievable goal, the effort to spread the benefits of microenterprise programs must be done through the development of larger programs. Paradoxically, a measure of success of programs is their ability to reach clients at a personal level and offer services that are based upon individual need. Scaling-up implies that the programs have to devise new institutions and methodologies not only to distribute, monitor and collect loans, but also to acquire and manage larger portfolios, while at the same time retaining the types of services that have made the smaller programs successful.

#### A. Objectives

The objectives of scaled-up programs are the same as the smaller programs that they are succeeding. Both have been instituted as a means to alleviate poverty through income and employment generation as it relates to the UIS. Ultimately the programs will be judged by their ability to reach more clients, nevertheless, by furthering the work of the smaller programs, scaling-up must assume the other objectives of providing training and technical assistance to clients and fostering social benefits. We know that training

is an important component of SME programs because they are dealing with inexperienced entrepreneurs. Similarly because poverty is a function of lack of resources and political powerlessness, scaled-up programs must address both if they are to be of use in determining a positive resolution to the problems. If the power to engineer the politics of a country does exist, the potential of scaled-up programs to be more effective at organizing or advocating reforms than the smaller programs, is relative to the increase in outreach of scaling-up programs. The examples of numerous scaled-up programs in South Asia are evidence of the important gains that can be made at a human level as well as at a structural level.

#### B. Organizational Structure of Scaled-up Programs

Two models of scaled-up programs exist: a) a decentralized, single-institution model and b) a multi-institutional decentralized model<sup>10</sup>. Both models emphasize the decentralized nature of program control in recognition of the need to keep organizations close to the grassroots. These structures lend themselves to greater flexibility and local decision-making, although bounds do exist, to reflect the specific concerns of particular funding constituencies.

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<sup>10</sup> Otero, 1989, p.75.

### 1. Decentralized single institution model

The best known example of this model is the Grameen Bank of Bangladesh. This is also the model which will be used by Bancosol in Bolivia. This model has a central office but is effectively run through branches. The main implication with this model is that the procedures are consistently applied throughout the entire network because it is one institution.

### 2. Multi-institutional decentralized model

This model is being developed in Colombia by the Asociacion Grupos Solidarios (AGS). The AGS functions as an umbrella group for 17 affiliate programs that operate independently throughout the country. The purpose of the AGS is to pool resources in such areas as technical assistance, training, research and evaluation so as to ensure that programs can function efficiently and continually expand their programs. Clearly, because different programs exist under the umbrella, variations in services will exist, but at the same time there are specific criteria to enter this organization which makes the differences minor.

### C. Source of Funds

While funding from international sources is clearly a major factor in implementing programs two other sources are generally used: client savings and private banks.

## 1. Commercial sources

Because NGO programs are not legally entitled to capture savings, they generally act as intermediaries for the private banking sector. This can have two advantages for programs: having clients deal with formal institutions increases the likelihood of repayment because the program is less associated with charity, and it is less demanding on the personnel of the NGO. Other advantages are perceived to be; educating commercial banks of the credit worthiness of SME operators, and familiarizing clients to the banking system (Ashe, 1985 p.101).

Although their record of lending to individuals is poor, private banks have loaned money to established SME programs with strong portfolios. In the Dominican Republic, both ADEMI and ADOPEM capitalize their portfolio partially through regular commercial loans. This has allowed the programs to increase substantially their client outreach. It also ensures that they remain conscious of their institutional efficiency because of the payback requirements of commercial loans. It should be noted that only the most efficient programs as measured by stability of portfolio and institutional self-sufficiency have been able to access these funds. Banks are not development oriented. They see SME programs firstly as investments and secondly as exercises in public relations.

In working with commercial banks, the SME program effectively becomes the manager of a fund offered by the bank. The program retains all its functions of selection and monitoring, while the bank need only monitor one large loan made to the program (Jackelen, 1989 p.140-41). In terms of scaling-up, the advantage of this system is the ease in which it can be implemented.

While providing advantages for SME programs, the role of financial intermediation is not ideal for scaling-up. The experience of the Grameen Bank is illustrative. Originally, Grameen was set up with support from the central bank and acted only as a distributor and collector of money. Grameen soon found that while it was doing all the work of maintaining the program, the central bank was reaping the profits by having its asset base increased by the savings of the poor. Because the banks tend not to make loans to SME's, this situation represents a leakage or transfer of resources from the poor to the central banks regular clients. This means that programs are not effectively using all resources available to expand their services to the informal sector. Reacting to minimize this leakage, Grameen evolved into its own financial institution.

Another disadvantage of financial intermediation is the cost to the end user. Programs that take unsubsidized loans must charge a higher interest rate because of the need to cover its cost of capital (for effective interest rates

charged by organizations, refer to Table 5.1).

## 2. Savings Mobilization

A not very well understood phenomenon in developing countries is the role of savings among the poor. This is the case because savings are generally kept outside of regulated institutions and information is not readily given by respondents during surveys. However, it is very apparent that their role in the informal sector is significant. This is demonstrated through the majority of informal businesses being started with personal or family savings. In two *barrios populares* in Santo Domingo, 72.8 percent of the businesses were financed initially through personal savings and another 12.2 percent through loans from friends (Vargas 1989, Table 27). Similarly, one of the chief myths about the poor to be shattered by SME programs is their supposed unwillingness and inability to save. The experience of SEWA and ADEMI evidence this point. In eight years of operation, SEWA members, who are among the poorest of the country, opened 14,000 bank accounts totalling over Rs.3 million. ADEMI shows accumulated savings (held in commercial banks) until Dec. 1990 equal to RD\$8,641,971. This is approximately half of its active credit portfolio. The majority of programs today have forced savings requirements or strongly encourage savings among their clients.

With the knowledge that savings are generated by SME



operators, and from the experience of the Grameen Bank, two of the three scaling-up programs in Latin America that are mentioned in this study are becoming full-fledged financial institutions. PRODEM in Bolivia is in the process of transferring its clientele to Bancosol and the AGS in Colombia is in the process of securing funding to initiate a credit union for its member programs. FONDOMICRO, of the Dominican Republic is structured as a financial intermediary. Creating an institution is a long procedure and potentially expensive because it involves meeting the legal criteria set out for banking operations by the state. The implementation of Bancosol took nearly two years and over US\$200,000. The advantages are that it is capitalized with US\$5.5 million and will not have to write another funding proposal (Salloum, 1991 p.7).

Independence is only one of a few other reasons why becoming a financial institution is the best methodology of scaling-up. Others include: it will ensure that all funds generated will be reinvested in this sector; Accepting savings can lead to lower interest rates if the cost of interest paid to savers and of making the operational and managerial changes are less than the cost of borrowing from other sources; SME banks are able to issue bonds or shares that will provide it with further sources of relatively cheap capital and they will qualify for discounted funds offered by the IDB and the World Bank (Bancosol proposal

paper, 1991); finally, becoming a financial institution requires that the organization have competent managerial staff and monitoring systems otherwise people will not agree to put their savings into the bank (see Tendler, 1989).

#### D. Locus of control

The capitalization of scaling-up is crucial because the largest contributors will be those who dictate the program design through the criteria of evaluation. The closer an organization is to its clients, the more likely it is to be responsive to their needs. In these cases, the provision of non-revenue generating services will be an important part of the program component mix. On the other hand, the closer the program relates to the agenda of the donors, the more likely the program will be limited by quantifiable evaluation criteria like institutional self-sufficiency and jobs created and strengthened. In these cases the programs are not developmental in a holistic sense, rather they perpetuate existing political and economic structures:

"There is a recognition to work with NGO's, but there is a tendency to 'use' NGO's to 'deliver' inputs rather than to catalyze a new approach for poverty alleviation. Donors (with few exceptions) too often bring their own perceptions, procedures, consultants and vested interests into the process. If the Grameen Bank expansion was a success it was because donors were not able to impose their procedures and followed the leadership of the pioneer effort" (Wignaraja, 1990 p.113).

Who controls the scaling-up process is of great importance

in determining the direction and the impact of the intervention.

## VII. Conclusion

Private sector led SME programs are an increasingly popular intervention designed to alleviate the problems of poverty and unemployment in the UIS. There are a variety of models of SME programs represented by three basic program designs: enterprise formation, enterprise expansion and enterprise transformation. Each of these designs incorporates the three basic components of credit, technical assistance and training, and social promotion to a varying degree. It is the weight given to each of these services which makes programs relevant to a specific clientele within the informal sector. Formation programs are oriented towards the poorest, expansion programs to established businesses and transformation to relatively large businesses. The services which each design offers to its clientele are essential and without them assistance would not be relevant to that particular clientele. This means that if assistance is to be offered to all levels of the informal sector, all types of programs must exist.

Programs are typically evaluated by assessing the impact of the components and the institutional self-sufficiency. In the case of the former, conventional

economic analysis is not sufficient to adequately capture the full impact of training and social organization. Therefore the expansion design programs, which minimize non-revenue generating programs, appear far more efficient than either the formation or transformation programs and have been emphasized in the scaling-up process so far. For this reason, comparative analysis of program efficiency should only be done between programs with similar designs. In terms of self-sufficiency, this concept should be replaced by the term 'sustainability', in order to acknowledge that some degree of subsidy is required to support SME programs.

The scaling-up process is in its infancy in Latin America. In this effort Bolivia, Colombia and the Dominican Republic are the leading countries in developing methodologies. At present the focus of discussion is on institutional structures, particularly capitalization. Experience suggests that the private banking sector has been inflexible in changing its structures or procedures to include smaller businesses. Moreover, increasing liquidity shortages resulting from tight monetary policies reinforce the bias towards large institutional borrowers. Programs working as intermediaries for the commercial banks can access loans, but must be seen as a worse solution than expanding into a bank because of: the leakage of potential capital sources; possibly higher interest rates and a locus of control removed from the clients. Furthermore, because

private banks have proven their intransigence towards aiding the UIS, they should not be the recipients of its fruits, as intermediation implies. Creating a financial institution is a better methodology for capitalization of scaling-up programs because: there is no leakage or transfer of resources, the cost of capital may be lower, the locus of control can rest closer to the client, and it may provide a greater possibility to fund all program designs. All these advantages are important in directing aid to the UIS and as importantly, are elements which contribute to the possibility of internally induced structural change.

## **Chapter 4. The Dominican Republic**

### **I. Introduction**

After a brief description of the geographical, political and economic aspects of the Dominican Republic, the purpose of this chapter is to describe the formation and structure of the urban informal sector and to assess the validity of the current theories. This is accomplished by analyzing the development strategy advocated by the state since 1965. In the Dominican Republic, the UIS is tied tightly to the policies of orthodox economic development. In this sense, the UIS and the problems contained within it are structural; they develop automatically from the policy regime. The conclusions drawn from this chapter will be used to assess the theoretical underpinning of the scaling-up process and ultimately its relevance in resolving the problems of poverty and unemployment in the UIS.

### **II. Location and Economic Regions<sup>1</sup>**

The Dominican Republic shares the island of Hispaniola with Haiti located slightly south and east of Cuba and to the west of Puerto Rico in the Caribbean Sea. Its land mass of 48,734 sq. km. makes it the second largest country in the

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<sup>1</sup> Greater detail of these aspects can be found in either of Wiarda and Kryzanek 1982, Knippers Black, 1986 or in Kryzanek and Wiarda 1988.

region. At 3,125 m. Mt. Duarte's peak, the highest in the region, descends into fertile agricultural land and further to sandy beaches that spot the coast of the country. Four other cordillera dissect the country into three distinct areas. The Cibao Valley's prime soil has ensured its importance to the country as an exporter of crops and produce. That region's capital, Santiago de los Caballeros, is the second largest city in the country, attracting attention as an alternative commercial and cultural center in the country (Kryzanek and Wiarda, 1988 p.6). The second and most important region in terms of the country's historical wealth is the Eastern region which contains the majority of sugar cane fields. Diversification from reliance on the sugar industry has been a priority of all governments since the mid-1960's. Key centers for the production of raw sugar or sugar products include San Pedro de Macoris, La Romana and Higuey. The last region identified is Santo Domingo. As the nation's capital it has become the administrative, cultural and economic center of the country, particularly since the Trujillo era. It is nearly five times larger than Santiago holding 2.2 million of the estimated 7 million Dominicans (EIU Country Profile, 1991 p.3).

### III. Political History

Western history of the Dominican Republic dates back to

the earliest days of the conquest by Columbus. The island was colonized by the Spaniards in 1492 and Santo Domingo became the capital city upon its founding by Bartholomew Columbus in 1496. It became the center of Spanish hegemony in the region. The first hospital, monastery, cathedral and university in the Americas are all located within the city. Its importance during this period is emphasized today as Santo Domingo is a focal point of the Quincentenary of the "discovery" of the Americas.

As the center of Spanish control, the island also has a history of conflict as the colonial forces of Spain, France, Britain and later the United States fought to achieve dominance in the region. English pirates repeatedly intercepted Spanish vessels or made attacks on coastal cities during the late 1500's. The French threat was more direct. By 1660 they had wrested the western third of the island from the Spaniards, creating what later became Haiti. As a result of the French Revolution, uprisings among the slave population throughout the island, with the support of French forces, completely removed the Spaniards in 1795. This situation was not stable and the government of the country passed back to the Spanish in 1809 and again to the Haitians in 1822.

It was not until 1843 that Juan Pablo Duarte, Ramon Mella and Francisco del Rosario Sanchez began to establish an independent network of power based on national identity.



These three men are considered the Founders of the Nation and February 27, 1844, the day of independence.

Independence did not bring with it stability. In fact the country has suffered from a number of crises that have consistently led to larger forces intervening. In 1861, the government leaders applied to Spain to re-annex the island. The Spaniards obliged but were once again run from the country in 1865 by popular movements. In the early 1870's, a financial crisis led the government to attempt to lease Semana Bay to the U.S. A lengthy and brutal dictatorship restored political order to the country but could do nothing about the economic problems. By 1905, international pressure for loan repayments led to the U.S. taking over the handling of customs receipts and distributing them between the government of the Dominican Republic and international creditors.

Continued political and financial turmoil prompted the U.S. to propose that they take over complete financial control of the country and a restructured Dominican constabulary. Domestic opposition led to direct U.S. intervention and rule through martial law from 1916 until 1924 at which time control was left to the military under Raphael Leonidas Trujillo.

As Trujillo moved into the power vacuum left by the departure of U.S. troops, no one could have imagined what was to be his legacy. His rule of thirty years "was probably

the strongest and most absolute dictatorship ever to be established in Latin America and perhaps the most personal dictatorship in the world" (Wiarda, 1968 p.179). Towards the end of his time, he was such an absurdity that even follow dictators Anastasio Somoza of Nicaragua and Stroessner of Paraguay remained at arms length (Knippers Black, 1986 p.28).

#### IV. Contemporary History

##### A. Continuity vs Change

In December of 1962, elections were held to choose Trujillo's successor. Juan Bosch led the *Partido Revolucionario Dominicano* (PRD) to victory on a platform based on opposing not the remnants of Trujillismo, but the oligarchy who rode the coat tails of the dictator<sup>2</sup>. Bosch's government brought in wide-ranging changes in all spheres of the country: a new Constitution definitively separated Church and State, divorce was legalized, peasants and laborers were protected by legislation, civilian control was attempted over the Armed Forces and the process of dismantling the Trujillo fiefdom in an egalitarian manner was begun (Knippers Black, 1986 p.31).

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<sup>2</sup> In amassing his fortune Trujillo, made many enemies among the elite class whose wealth he confiscated. However, because of Trujillo's totalitarian power his enemies had little recourse. Many continued to live very well by co-operating with the regime and therefore enjoying a portion of the accumulation of the assets, albeit smaller than before. (See Knippers Black, 1986 p.26)

The traditionally powerful Army, Elites and Church were highly agitated and with the fear of Castro still gripping the region, overthrew the government after only seven months. One of their first acts was to set up a ruling Triumvirate and annul the new Constitution<sup>3</sup>.

The role of the U.S. administration in this action is uncertain. It appears that elements of the Kennedy administration supported the Bosch government and other factions did not<sup>4</sup>. This ambiguity evaporated with the death of Kennedy and President Johnson's support of the traditional power structure in the persona of Joaquin Balaguer<sup>5</sup>, the ex-Presidential Secretary for Trujillo. It is even more obvious in 1965 when Johnson sent marines to support the traditional forces against a popular uprising of a pro-PRD supporters who were trying to re-establish the Constitution implemented by Bosch. Without the American intervention it is likely that the traditional forces would

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<sup>3</sup> The Triumvirate was comprised of three civilians but was placed under 'tutelage' of the military.

<sup>4</sup> Knippers Black reports that President Kennedy sent one of his advisors to investigate the possibility of staging a counter-coup to reinstate Bosch. Furthermore he withdrew the ambassador, suspended aid and never recognized the "Triumvirate" that replaced Bosch. However others clearly were agitated by the Leftist reforms implemented by Bosch. The ambassador, John Bartlow Martin, is believed to have had prior knowledge of the coup but remained silent. The CIA has also been implicated for its instigation of anti-Bosch activities leading up to the coup. (See Knippers Black 1986 p.33-36).

<sup>5</sup> In reference to Balaguer, Herman and Brodhead report a former CIA officer, Ray Cline, emerging from a meeting with Johnson with the orders "Get this guy in office down there". Herman and Brodhead, 1984 p.46.

have lost control of the Presidential Palace<sup>6</sup>.

Cessation of fighting resulted in an interim government and another election in July of 1966. The result of this election was tainted, but Joaquin Balaguer emerged as the President<sup>7</sup>. He held this post for twelve consecutive years inspite of constitutional law against re-election. This period has been dubbed 'Trujillismo without Trujillo' (Knippers Black, 1986 p.42).

The PRD was returned to power after elections in 1978 and in 1982. The governments of Antonio Guzman Fernandez and Jorge Blanco are considered as crucial in introducing more participatory democratic structures into the political sphere<sup>8</sup>. Their gains in this area were not matched in the economic sphere. The increased ability to obstruct presidential legislation, the beginning of the global recession, declining terms of trade and lack of commitment

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<sup>6</sup> There was actually two coups. The Triumvirate was deposed on April 24, 1963 by right-wing forces who were similarly attacked by PRD supporters within the army and civilian society. By April 27, the PRD forces controlled most of Santo Domingo and were ready to take Santiago. On April 28, 23,000 US troops took up positions around the country in order to prevent the PRD forces from re-establishing their government. Two days of fighting ensued before the OAS demanded and received a cease-fire. The OAS intervention allowed the US to act under cover of a multi-lateral arrangement and establish a better bargaining position for the existing government. Fighting broke out again in mid-June ending with both sides calling for the removal of the peace force.

<sup>7</sup> Knippers Black suggests that because the elections were held while US troops were still in the Dominican Republic this amounted to a powerful deterrent to Bosch supporters. Furthermore international election scrutineers were not given free access to the polls but had their schedule coordinated by military officers. Finally the number of ballots registered in 1966 was 25 percent higher than two years earlier, a number which corresponds almost exactly to the margin of Balaguer's victory. (Knippers Black, 1986 p.41).

<sup>8</sup> See Kryzanek and Wiarda, 1988 pp.65-70.

to reforming economic structures all contributed to these governments becoming discredited in the eyes of the electorate.

In 1986 Balaguer was returned to the Presidential Palace where he remains today. While many initially saw the return of Balaguer as a step backwards in the process of institutionalizing democratic practices in the country, these concerns are unfounded. Elections have continued and in fact Balaguer has flirted with the image of a populist leader in recent years (Kryzanek and Wiarda, 1988 p.147).

#### B. Political and Economic Influences

The present economic and political structures of the Dominican Republic must be understood in context of the influence of the U.S. and the domination of the country by Trujillo.

Twice in this past century U.S. troops have invaded the country. The first in 1915 lasting until 1924 and the second in 1965 until 1966. Even the intervening period of Trujillo's dictatorship can be seen as a function of U.S. influence:

"Trujillo's rule also provides an interesting case study of how the United States bolsters dictators who support their policies, and then moves to undermine and, in this case, even assassinate them when they have outlived their usefulness" (Wiarda and Kryzanek, 1982 p.2).

Thus, for nearly fifty years the political leadership of the

Dominican Republic has been directly linked the U.S.

In more recent years, with the institutionalization of elections, dependence has been shifted to the economic sphere. This is indicated by the fact that one reason for the lack of support for Bosch in Washington was his attempt to attract European investment and financing and to forge economic linkages with a variety of other countries (Knippers Black, 1986 p.32).

In concrete terms the U.S. maintains dominance by having provided nearly 75 percent of the total bilateral aid between 1978-83 (Kryzanek and Wiarda, 1988 p.162). It received 77 percent of the exports and provided 41.3 percent of the imports in 1989 (EIU Country Profile, 1991 p.26). In 1986, it was the source of origin of 68 percent of the total foreign investment and of 85 percent of companies within the export processing zones (Kryzanek and Wiarda, 1988 p.145). As important are the remittances which Dominicans send back from the U.S. which amounted to US\$326 million in 1988 (World Development Report 1990 p.250)<sup>9</sup>. Kryzanek and Wiarda conclude:

"At every important position of power in the Dominican Republic one can find a "parallel power" from the outside that acts as either a controlling agent or is an essential contributor to the internal power structure" (Kryzanek and Wiarda, 1988 p.124).

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<sup>9</sup> The United States including Puerto Rico is the largest recipient of legal Dominican emigration and while the level of illegal emigration is unknown, some estimate it to be equivalent to legal migrants. It can be assumed that the illegal immigrants have the same target destinations (see Reyes, 1989 p.13).

Clearly, these "parallel powers" reside in the U.S. with the exception of the IMF's role in setting the parameters of macro-economic policy. This outside influence also explains why the governments of the PRD followed an economic plan similar to that of Balaguer despite being quite distant ideologically. The lack of ability to independently determine its political-economy is the source of the crisis today. It means the Dominican Republic is a case study of dependent capitalist development<sup>10</sup>.

While external forces have direct influence on Dominican policies, as significant is the way in which the U.S. domestic policy fundamentally changes the structure of the Dominican economy. The reduction of the sugar quota by the U.S. administration due to "domestic political interests"<sup>11</sup>, combined with "807 program", which gives tax relief on products which are produced off-shore but use U.S. inputs, has cost more than 50,000 jobs in the rural areas, while creating an estimated one-fifth of all urban jobs through expanded demand for labor in the export processing areas (see box 8.1 World Development Report 1990 p.122). The Dominican government must therefore attempt to deal with problems like rural unemployment and continuing rural-urban

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<sup>10</sup> Dependent capitalism in this case refers to the reliance on foreign countries, but particularly the U.S. and U.S. based TNC's to provide the resources, investment, markets and technology to stimulate economic growth.

<sup>11</sup> The sugar quota on imports was reduced in 1985 to protect the domestic market for sugar beet farmers.

migration which have an uncontrollable element.

While the dependence on the U.S. is apparent, an even deeper scar on the psyche of Dominicans is the legacy of the dictator Trujillo. Over his thirty year rule from 1930 to 1961 he dominated every single aspect of the country. He was the first businessman of the country accumulating the majority of its productive resources<sup>12</sup>. He completely controlled the political sphere through a vast network of security forces which spied on all sectors of society and eliminated dissenters<sup>13</sup>. He even became the personal guardian of the majority of the people by directly employing nearly half of the labor force and another 35 percent indirectly through the government (Knippers Black, 1986 p.27). Upon his assassination in 1961 his wealth was estimated at between US\$300 and \$1,000 million, making him one of the richest men on earth (Wiarda and Kryzanek, 1982 p.36).

In the wake of Trujillo came a civil war that killed thousands of Dominicans as they fought over control of the Trujillo empire and in essence the wealth of the nation. It fuelled the call for a participatory democracy and economic

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<sup>12</sup> Herman and Brodhead state that Trujillo owned as much as three quarters of the assets of the country, included 50 percent of all arable land. He controlled all major industries: salt, milk, meat, sugar, tobacco, cement, paper, wheat, airlines, newspaper, radio and television industries (see Herman and Brodhead, 1984 p.19).

<sup>13</sup> Though the violence against the public took many, many lives, the horror of Trujillo's rule is exemplified in his supervising the killing of between 15,000 to 35,000 Haitian squatters over a two day period in 1937 (Herman and Brodhead, 1984 p.21).



policy based on the needs of the nation as opposed to the vanity of the few.

Assessment of the impact of the U.S. and Trujillo on contemporary Dominican society by Wiarda and Kryzanek concludes that there is very much a love/hate relationship between Dominicans and these dominating entities. With the United States, on one hand there is the practical knowledge that it provides the means of economic well-being and fuels the dreams of many, on the other, there is resentment of the direct and indirect intervention into the internal affairs of the country. With Trujillo, while there exists a deep revulsion at his personal greed and tactics, there is at the same time an admiration of the "strength, showmanship and national accomplishments" that his era provided (Wiarda and Kryzanek, 1982 p.20-21).

#### V. Development strategy since 1965

Because of the consolidation of power and resources under the Trujillo dictatorship it is the restructuring of the economy after his death that is particularly relevant to this study. Moreover it is after this date that a fundamental shift in the philosophy of government took place which defined economic development as the priority of the political-economy of the country (Wiarda and Kryzanek, 1982 p.71).

As a country whose policies are guided by outside sources, economic development in the Dominican Republic has been perceived in an orthodox fashion: the formation of a high value-added industrial sector<sup>14</sup>. The starting point of this process was as an exporter of non-oil primary resources. Because these are common with many countries in Latin America, the Dominican Republic is exemplary of the development process in the region and provides evidence of the relationship between growth of the UIS and dependent capitalist development.

The transformation to an industrialized country was based on trading commodities for capital goods. However, the tendency of revenue from primary products to be insufficient to cover both the cost of importing capital goods and oil during a period of import substitution industrialization led to a position of indebtedness.

To correct current account deficits, the response of the government has been to attempt to boost the level of earnings, establish other forms of revenue generation and implement tight fiscal management and monetary policies. The three current pillars of the Dominican development strategy as chosen and supported by the government are exemplary: agroexports, export processing zones and tourism. The government also has to rely on the IMF to provide short

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<sup>14</sup> This definition is favored by Dr. P.Bowles as capturing the essence of the intention of governments.

term financing and therefore has agreed to the macro-economic adjustments on a number of occasions in the 1980's.

Within this development strategy the UIS of the Dominican Republic has been growing. In order to assess the current theories reviewed earlier, the mechanisms of this growth must be analyzed. The following is a discussion of how the policies of development have effected the growth of the UIS.

#### A. Rural scenario

The consolidation of arable land by Trujillo in the 1940's started the flood of displaced campesinos to urban areas. It also began a system of orienting production to external markets rather than for the domestic market because of higher profitability and need to pay for industrial development. These two themes run steadily through the rural development policy of the country and have had an important impact upon the growth of activities in the UIS.

According to Ceara-Hatton during the 1969-1979 period the role of the agriculture sector was threefold: 1) to guarantee a supply of low priced foods to the urban zones to maintain low real wages, 2) to provide financing of imports with the revenues from exporting traditional products and 3) to create a surplus labor force available for the industrial sector (Ceara-Hatton, 1990 p.84). Due to relatively consistent policy application, the role of the agricultural

sector remains the same. Examples of the three roles are listed below.

1. Low domestic food prices

INESPRE (Price Stabilization Institute) was created by Balaguer as a marketing board for rural producers. It remains the pivotal government institution in determining supply and demand of domestic production. Through it and other smaller institutions, the government has direct or indirect control of nine of 10 basic commodities that make up the normal diet of Dominicans<sup>15</sup>. INESPRE is also charged with importing products to meet domestic shortages.

Low prices for domestic food growers diverts production to more profitable export products and forces the government to rely on imports to meet the food demand. The maintenance of low prices for food products is shown in Table 4.1 by the increasing disparity of supply and demand of food production. This is further emphasized by recorded reductions in all the staple starch crops: yuca, yutia, batata, name and potatoes between 1973 and 1981 (see Ceara-Hatton, 1990 p.89).

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<sup>15</sup> The ten products are rice, sugar, wheat, red beans, plantain, pasteurized milk, chicken, beef, peanut oil and coffee.

Table 4.1                    Agriculture and food imports  
                             compared with growth of urban demand (1970-1981)

	urban demand	animal husbandry	crops	cereal imports	Food aid
	percentage change			year / 000's	tonnes
1970-1981	5.7	3.6	2.7	1972 / 242	1974-5 / 16
1980-1985	4.2	na	na	1986 / 545	1985-6 / 125

Source: Ceara-Hatton, 1990 p.87  
World Levelment Report 1990 p.232

While normally increased food imports would imply an increasing current account deficit, cheap food imports available from the U.S. under P.L.480 prevent this situation<sup>16</sup>. The ability to meet food demand through subsidized imports and food aid, ensures that the price to domestic producers will remain at low levels. This translates to low wages in the urban sector as the cost of maintaining the labor force is low. The relation between low prices for domestic food producers and low urban wages is not only strong, it is supported by the international system and is structural.

## 2. Export earnings

Reliance on the agriculture sector to finance

<sup>16</sup> Public Law 480 provides low cost loans to developing country governments which they must use the loan to buy food products from the U.S. The government of the Dominican Republic then sells these food crops at a profit and uses the proceeds to finance other types of development projects. The types of projects financed are negotiated with the U.S. officials.

development is a historical given in the Dominican Republic. The country depended primarily on sugar exports but others included coffee, cocoa and tobacco. Tremendous fluctuations in world commodity prices in the mid-1970's and 1980's reeked havoc with the balance of payments and spurred the government to intensify the diversification of its revenue earning base. The effort to produce new export crops; pineapples, African palm and other fruits and vegetables is expected to rise to US\$600 million in 1992 from \$429 million in 1988 (EIU Country Profile, 1991 p.13). The development of mineral production, especially gold and ferronickel, can be claimed as a success in some aspects. Table 4.2 shows that in 1988, as compared to 1965, other primary exports declined, while virtually all other types of exports increased. The economy is still heavily reliant on primary products for export revenues (74%) and with further advances in biotechnology and synthetic materials, the future will undoubtedly see a further deterioration of primary products prices. This means that the diversification program has serious limitations. It should also be stated that the trade balance since 1985 has not been positive.

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Table 4.2 Structure of Merchandise Exports (% of total exports)

Year	Fuels minerals and metals	Other primary	machinery and transport	Other manufac.
1965	10	88	0	2
1988	21	53	6	20

source: World Development Report 1990 p.203

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### 3. Land distribution

Whatever the product grown, the reliance on the agricultural sector to produce revenue encourages the use of modern technologies on large tracts of land in order to maximize profitability. It also provides major incentives not to distribute land to peasant farmers who are more likely to grow subsistence crops. The redistribution programs initiated by Balaguer and Guzman have not impacted upon the structure of land-holdings in the country which remain highly skewed towards large farms as they were in the era of Trujillo. This is shown in Figure 4.1.

Furthermore, when Figure 4.2, which shows the stagnation of traditional exports and food production, is viewed with the knowledge that agroexport production is increasing steadily, it is apparent that whatever new land that has been distributed or opened since 1981 has been used for non-traditional exports.

Agroexport production either displaces or uses seasonal labor. The result of un- or under employment is rural-urban

migration and generally growth of the UIS. In this respect, the internal migration of the Dominican Republic differs from the standard pattern in Latin America only by the degree of intensity. Table 4.3 shows the increase in urban population over a sixty year period ending in 1981. In other terms, this Table translates into an annual rate of urban growth of 5.8 percent from 1960-70 and of 5.3 percent from 1970-80 (Gilbert and Gugler, 1982 p.6-7). Both figures are the highest recorded in Latin America during their respective periods. The final destination for most of this migration has consistently been Santo Domingo whose population today includes nearly one-third of the entire population.

Development of the rural sector in the Dominican Republic fits neatly into a national system that emphasizes industrialization and an external system designed to benefits farmers, consumers and bankers of the developed countries. The requirements of these systems over the past thirty years have created structures which promote low prices for domestic food producers, rural-urban migration and low wages in the urban industrial sector. Proponents of this development strategy point to benefits brought by



Figure 4.1 Structure of land holdings

Size tareas*	----- 1973 -----			----- 1981 -----		
	% total number	% of total area	avg. size	% total number	% of total area	avg. size
<79	77.1	12.8	23.8	81.8	12.2	16.5
80-799	20.6	29.9	207.4	16.4	32.6	218.9
>800	2.3	57.3	3511.9	1.8	55.2	3340.6

\* refers to the amount of labor required to work the land  
source: Ceara-Hatton, 1990 p.53.

Figure 4.2 Agriculture Production ('000's tons)

	1984	1985	1987	1988	1989
sugar cane	10,995	8,217	8,772	8,375	7,856
rice	507	494	515	460	462
tomatoes	162	165	173	163	173
coffee	144	144	134	136	129
kidney beans	67	48	52	53	54
cocoa	33	35	39	41	42
cotton	6.2	5.9	7.4	8.0	8.4

source: EIU Country Profile, 1991 p.15

Table 4.3 Population growth and level of Urbanization

	YEAR		
	1920	1950	1981
Total population	894,665	2,135,872	5,647,977
Urban population	148,849	508,408	2,935,860
Percent urban pop.	16.6	23.8	51.98

source: Ariza, Duarte, Gomez, Lozano p.25

increases in export revenues and international accreditation as a good debtor. This type of argument overlooks the detrimental impact that dependent capitalism has had on the standard of living in both rural and urban areas for the majority of the people. Wiarda and Kryzanek write that in 1988: "the rural population is underfed, underclothed and forced to live in thatch and mud shacks (bohios) with no running water and usually no electricity" (p.105).

The relation between rural poverty and increase in the UIS should not be underestimated either. Conditions of squalor and the inability to work, force people to relocate. The rapid rate of urbanization caused by an unequitable land distribution pattern increases urban unemployment and poverty levels.

## B. Urban Scenario

### 1. Private Sector

The private sector has always played an important role in the development strategy of the government. Initiation of the industrialization program in 1969 under Law 299 concerning Industrial Incentives was designed to give it a leading role in creating jobs. These incentives had four components:

- i) exemption of capital goods from import taxes.
- ii) exemption of intermediate products and primary materials from import taxes.

- iii) exemption of fuels (excluding gasoline) from import taxes.
- iv) income tax exemption.

The level of exemption for foreign investors engaged in production for export purposes was 100 percent in all cases. Companies producing for the domestic market had up to 95 percent exemption status in the first three categories and 75 percent over the first five years in the last (Ceara-Hatton, 1990 p.76).

The impact of Law 299 was to make export processing zones the major source of employment creation in the industrial sector. In 1979, EPZ's had 24 firms and were employing 11,500 people under a roof space of 925,000 sq. ft. In 1990, this had expanded to over 330 firms employing over 130,000 people in 8,688,115 sq. ft. of production area. The amount of exports over the same period increased from US\$117 million to US\$838 million (CIECA 1991). EPZ's now account for half of the employment in the manufacturing sector and have produced the majority of the increase in manufacturing exports (World Development Report, 1991 p.122).

The final pillar of the economy, the tourist industry, like the other two has provided the government with a very significant new source of revenue. Gross earnings in 1989 were US\$675 million and are projected to rise to US\$750-\$800 million in 1990 (EIU Country Profile, 1990 p.21). This can be seen as positive sources of earnings and new

employment; the sector employs only an estimated 50,000 people directly and another 50,000 indirectly (EIU Country profile, 1990 p.21).

Despite this impressive increases in employment, production and government revenue, the impact of the industrialization program on the domestic economy has been minimal. In the manufacturing sphere, and the during the construction boom that preceded the development of the tourist industry, because of incentives given by Dominican government to foreign companies, few backward linkages are made with Dominican industry. This is shown by the increasing tendency to import both capital goods and other manufactured goods. Of total imports in 1965, machinery and transportation equipment accounted for 24 percent and other manufactured goods 40 percent. In 1989, the figures for the same two categories were 30 percent and 47 percent respectively (World Development Report 1990).

The isolation of the industrialization program from domestic economy means the benefit to the country must come from the wages paid to employees and their propensity to consume. However, production in the formal Dominican economy is based on low wages to ensure a competitive advantage in the global market place. In 1985, in the EPZ's, the average wage was US\$0.37 per hour (Kryzanek and Wiarda, 1988 p.136). Furthermore Ceara-Hatton shows that the wage rate in these areas has not increased with productivity. Between 1970-79

productivity increased 2.9 percent annually while real income fell 5.6 percent annually (Ceara-Hatton 1990 p.77). Clearly companies want only to maximize profits and have little regard for either the workers or the country in which they are producing. EPZ's are generally encircled by high fences with barbed wire and armed guards, unionization is actively discouraged. They have been referred to as modern slave camps by those interested in human rights (Knippers Black, 1986 p.67).

Development of the tourist industry has had some positive spread effects. The production of ceramics, wooden objects and other souvenirs has driven the growth of an artesania industry. The quantity of artesania shops supported by programs like ADEMI and the FDD has increased continually proving that they are considered a viable business opportunity. Restaurants and other service industries that cater to the needs of tourists are also growing quickly.

The tertiary sector does not have the capacity to be the dynamo of an economy. The tourist industry is dependent upon many things including international and domestic political stability and a particularly paradoxical factor; the increasingly high demands of international travellers set against the deteriorating infrastructure of the nation. As the power generating capacity of developing countries erode, as well as the roads and cities, the tourist industry

becomes increasingly compartmentalized from the rest of the nation and thereby increasingly irrelevant to the development of the majority of people.

## 2. Public Sector

The public sector has played a vital role in providing stability in the political-economy of the country. At the highest levels, public sector appointments have traditionally been patronage handed out by the president as a means to ensure continued support. They have also been instrumental in creating a middle class in the country, which comprised some 15-20 percent of the country in 1986 (Knippers Black, 1986 p.57). As importantly, the inability of the private sector to absorb the increase in the urban workforce means that the government has had to play an active role in generating employment opportunities if only to ease social tensions. Each administration, Balaguer, Guzman, Blanco and again Balaguer, has expanded the public sector and/or used construction projects to stimulate the urban employment situation. Between 1970 and 1987, the number of government employees increased 109.6 percent to 207,900 (Inter-American Development Bank, 1989 report p.197).

However, it is increasingly difficult for the government to expand either the size of the public sector or the wage rate because of continued current account deficits

and SAP, either self-imposed or required as a part of IMF agreements. As in the rest of the world, the Dominican government has been greatly affected by the forces of conservatism that have required less government intervention and more private sector activity to stimulate the economy. The philosophy of SAP matches that of the neo-liberal theoreticians like de Soto, and therefore by analyzing the impact of SAP policies on the UIS, an assessment of this neo-liberal position can be made.

Table 4.4 shows the immediate impact of SAP which the government was implementing while positioning itself to qualify for an IMF loan. An agreement with the IMF was signed in July of 1991. The fact that these measures were self-imposed supports the claim that at least this government agrees with the fundamental underpinnings of the adjustment policies.

In the case of the Dominican Republic, the rise in cost of the basic food basket, transportation and decline of real wage rate most certainly induces informal activities. Furthermore, without providing statistics, Sang Ben states that an increase in commercial interest rates has limited small and medium sized businesses access to private lending sources and forcing them to close (Sang Ben, 1991, p.7). In an economy of surplus labor, business closures will also induce growth in informal sector activities. Reduced government expenditures in all areas of public

Table 4.4 Effects of SAP on selected indicators of the Dominican Republic economy.

Indicator	Before Application 1989(*)	During Application 1990(*)	Variation (%)
GDP (RD\$ 1970)	3,656.8	3,470.2	- 5.1
GDP per capita (1970)	522.4	482.0	- 7.7
Exports (US\$mns)	924.4	703.9	- 23.9
Imports (US\$mns)	1,963.3	1,807.0	- 7.9
Avg. min. wage	490.8	715.9	- 45.9
Real Nat. min. wage	63.4	58.1	- 8.4
Inflation rate	45.5	59.4	13.9
Cost of avg. family food basket	1,363.2	2,193.6	59.4
Unemployment	19.6	23.0	3.4
Public expenditures (real per capita RD\$)			
total social	335.6	243.2	- 27.5
health	10.8	8.4	- 20.8
education	8.9	8.2	- 7.9
water and sewage	5.8	4.9	- 15.5
Cost of public transport			100.0
Transport of food and industrial goods			40.0

(\*) preliminary figures  
source: ONAPLAN informe No.4 1991

infrastructure resulted in an estimated 30,000 public  
sectoremployees being laid-off over the course of the past  
year<sup>17</sup>.

Preliminary evidence would suggest that the impact of  
implementing this SAP has been towards that of urban  
pauperization or reinforced non-commercial relations rather  
than expansion of commercial activities as outlined by

<sup>17</sup> This figure was unsubstantiated by hard evidence but is considered to  
be an educated guess by an experienced economist in the Dominican Republic.



Hugon. The elimination of peoples ability: to pay for goods with cash; to obtain steady and secure employment; or to receive social benefits from the state creates the need to develop alternatives means of survival. The convergence of all these detrimental impacts is the prescription for the development of a heterogeneous sector that incorporates; the poorest and most destitute; the hard-working and able but poorly trained; the trained and educated who now need alternative incomes; the entrepreneur who sees viable opportunities in a vastly growing part of the economy without the harassment of bureaucracies; the capitalist who sees the advantage of avoiding costly benefits paid to employees.

In the past, SAP's have been broken due to political pressure to use the public sector to create jobs. However, job creation programs have proven to be of short-term relief and not sustainable. They do nothing to resolve the problem of producing goods in the economy and any gains made in wages are generally lost to inflation which increases when the currency is devalued<sup>18</sup>. For this reason, the government is less likely to jeopardize its most recent IMF agreement by resisting pressure to repeat these mistakes. The government is increasingly marginalized from playing a role

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<sup>18</sup> The high inelasticity of demand for consumer and industrial imports means that they will continue to be imported despite the higher cost after currency devaluation occurs. This phenomenon is known as structural inflation and is evident virtually everywhere in Latin America.

in stimulating the economy. The generation of jobs and economic growth is therefore left to the private sector in an atmosphere of SAP.

### 3. Urban Informal Activities

Due to the continued migration from rural to urban centers and population growth, the annual increase in the urban workforce is estimated at 50,000 persons (Kryzanek and Wiarda, 1988 p.102). The inability to consistently create an equivalent number of jobs in the public and private sectors means expansion of informal activities. This situation is shown between 1980-83 in Table 4.5.

Given the worsening of the economy since 1983 and the tendency of the public sector to expel workers, it is virtually certain that the informal sector remains the most dynamic sector of the economy.

Table 4.5 reveals that as a percentage of economically active people, employment levels declined in both the government and modern sector, while they increased in the informal sector. It also indicates a restructuring within the informal sector with ownership decreasing significantly and both piece-work and self-employment increasing significantly. This was reaffirmed by the MSI study in 1989 which showed that one-, and two- to five-person microenterprises were the most dynamic source of

Table 4.5.

Working Population 15 years and greater  
by occupational category and economic sector: 1980-1983.

Occupational category	Sector of Activity			
	Gov't	Modern	Informal	Domestic
1980				
Owners	0.3	3.7	13.4	-
Workers:				
fixed salary	95.7	74.8	15.9	82.2
piece work	3.5	14.6	7.0	4.9
self-employed	0.5	6.0	43.3	2.7
unpaid family	-	0.8	2.5	2.2
occasional	-	-	17.9	8.1
Total	24.6	36.8	27.2	11.4
1983				
Owners	-	3.8	6.1	-
Workers:				
Fixed salary	94.1	78.5	9.2	81.9
piece work	4.3	13.3	18.5	3.1
self-employed	1.0	2.9	48.4	3.1
unpaid family	-	1.6	3.9	3.1
occasional	0.7	-	13.9	8.8
Total	22.2	32.8	33.4	11.6

adapted from: Lozano, 1987 p.384

employment in the two largest cities. The decrease in ownership figures lessen the relevancy of the entrepreneurial spirit theories. To the contrary, these figures suggest the expansion of casual work and extensive job creation dominate the relations between sectors and the form of job creation in the Dominican Republic.

Two tendencies contribute to the expansion of these informal activities: the decline of real wages and

restriction of credit in the commercial banking system. Both are related to the orthodox development strategy. In the former, the decline in purchasing power makes single employment inadequate to purchase subsistence needs. The informal economy grows because it can provide flexible secondary or tertiary employment. In the latter, the restriction of credit, required by SAP, means that medium and small businesses must find other sources of credit to meet their needs, or close. In an economy of surplus labor, such as the Dominican Republic, the result of job loss most likely signifies an increase in the informal sector. Both of these tendencies do not exclude the possibility of non-exploitative work. Rather, they show the informal sector growing as a survival mechanism against structures which prevent full-employment and employment at an adequate rate of pay.

The level of the minimum wage is the most important statistic in determining incomes in an economy of surplus labor because it serves as the most common rate of pay. In the case of the Dominican Republic, it is set by the National Committee of Salaries under the State Secretary of Labor. Table 4.5 is misleading in the sense that the minimum wage included refers only to the public sector. Other minimum wages exist for large enterprises (the EPZ's and agroindustries), medium enterprises and rural workers. In 1989, the first two exceeded the government level, providing

a monthly wage of RD\$700 and RD\$650 respectively. The other two minimum wages were lower: RD\$450 monthly and RD\$15 daily (Vargas, 1989 p.70). In all cases the minimum wage offered is below the level of extreme poverty as estimated by CIECA.

The tendency for the real minimum wage to decline is shown in Table 4.6. In 1989, public sector employees received the lowest wage ever, and has been below the extreme poverty indicator since 1985. Between 1981 and 1987, the wage of public sector employees decreased 37 percent to the point where physicians and university professors were making wages comparable to waiters in luxury restaurants (IDB Report, 1989 p.210). This decline is the result of tight fiscal policies due to external debt management.

Because of the insufficiency of the minimum wage to buy the basic necessities of living, people must either work longer hours or find supplementary incomes. In either case it means that single employment, or fixed wage employment is increasingly irrelevant to people. In two of the poorest barrios in Santo Domingo a recent study found that 76% of the microentrepreneurs surveyed worked more than 45 hours per week, 53.2 worked more that 65 hours per week and 12.9 worked more than 105 hours per week (Vargas, 1990 table 15).

Table 4.6 Monthly Nominal Minimum and Real Wage and Level of inflation and Level of Extreme Poverty.

Wages in RD\$					Extreme Poverty
year	Nominal	Real	US\$	Inflation	
1970	60	60	52.17	-	47.55
1971	60	56	52.63	8.0	51.25
1972	60	51	53.57	9.26	55.99
1973	60	45	53.10	13.56	63.58
1974	60	39	52.63	13.43	72.12
1975	90	52	76.27	14.47	82.56
1976	90	48	75.00	8.05	89.21
1977	90	45	73.77	6.38	94.90
1978	90	42	72.00	7.0	101.54
1979	125	53	102.46	9.35	111.03
1980	125	45	99.21	19.02	132.15
1981	125	42	97.66	7.54	142.11
1982	125	39	85.62	7.65	152.98
1983	125	36	78.13	6.92	163.56
1984 (1)	158	37	55.94	24.46	203.56
1985 (2)	213	36	68.11	37.51	279.91
1986	250	39	85.91	9.75	307.19
1987 (3)	283	38	73.78	15.89	356.02
1988 (4)	385	35	64.71	44.99	523.33
1989	500	30	78.74	52.79	799.59

Note: 1) increase to RD\$175 in May  
 2) increase to RD\$250 in July  
 3) increase to RD\$350 in September  
 4) increase to RD\$400 in June for private sector and April for Public sector

source: CIECA, 23 August 1989.

The informal sector is also absorbing an educated middle class whose purchasing power is decreasing through: the contraction of real wages, the decimation of social programs throughout the 1980's and the inability to find employment in their field of training. ADEMI reports that in 1990, 8 percent of its clients were engineers, architects, economists and the like (Saunders, 1991 p.3). An IDB study of a subset of ADEMI clientele produced in July of 1991 found that 96 percent of those surveyed had attended school: 21 per cent had 1-5 years of university, 37 percent had completed 1-4 years of high school, 21 percent grades 7-8,

and 21 percent to grade six. This latter study also showed that there was no correlation between education and the present activity (Regino, 1990 p.56). While more information is needed to understand the reason for their location in the informal sector, it is most likely that the need of an income rather than entrepreneurial spirit is the major factor.

While middle and lower class people feel the greatest impact of the adjustment policies, similarly medium and smaller businesses are most hurt by the restriction of credit that also results from SAP. As credit becomes more scarce, loans are made to the most profitable businesses, which tend to be export-oriented, and are distributed through political or friendship networks. For those cut off from normal sources of credit, the only recourse is to go to unregulated markets where it can be obtained at a much higher rate of interest. Kryzanek and Wiarda state that there was an increase in the unregulated credit market, which charged between 30-60 percent annually, in the early 1980's due to the restrictive credit policies implemented (Kryzanek and Wiarda, 1988 p.128). In 1991, Sang Ben states that an immediate impact of the politics of adjustment is: "scarcity of credit and the incapability of small industrial producers to have access to private bank credit forcing them to close" (Sang Ben, 1991 p.7).

## VI. The Government's support of the Informal Sector

Direct government policy to aid the UIS in the Dominican Republic has been virtually non-existent (Kleinekathoefer, 1990 p.24). Even its financial contributions to assistance programs originate from donor countries. The money which it contributes to SME programs comes from the office of the Technical Secretary of the President. These monies however are in large part raised through the Economic Support Fund<sup>19</sup> or P.L.480. Because these revenues originate from U.S. sources, their expenditure is negotiated between the government and USAID. Therefore even the investment in NGO's servicing this sector should by no means be considered automatic.

The government's ambivalence towards the informal sector shows a firm belief in the market liberalizing policies of SAP as sufficient to resolving problems in the UIS. It also reflects the opinion of USAID in Santo Domingo. USAID believes that the government's role in supporting informal activities should primarily be limited to controlling the rate of inflation<sup>20</sup>. To the contrary, governments of other developing countries such as India or

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<sup>19</sup> The Economic Support Fund is comprised of monies donated by the U.S. government to the government of the Dominican Republic to help alleviate the impact of Structural Adjustment programs. In 1984-85 these payment amounted to US\$150.

<sup>20</sup> This was stated by Anne Beasley of the Department of Private Enterprise Support in Santo Domingo on May 15, 1990.



Colombia have taken a more active role in support through direct procurement policies or comprehensive plans that specifically aim at including support to the UIS into the National Development Plan. The unwillingness of the Dominican government to implement these types of support shows that the externally induced model of reform dominates in the country.

## VII. Conclusion

The political-economic crisis in the Dominican Republic is manifested in high poverty and unemployment rates and the incapacity of the government to act against them. The inability of the private and public sector to absorb the increase in the urban work force means that since the early 1980's, the UIS has been the most dynamic part of the economy in the Dominican Republic. Further evidence shows that the internal structure of the UIS is increasingly weighted towards casual work and the smallest businesses, which in theoretical concepts, corresponds to the survival strata and extensive job creation. In this case, the involutionary theories of the neo-marxist or organizational restructuring approaches have greater explanatory power than the evolutionary approaches.

The growth and dominance of the survival strata of the informal sector can be seen as a structural feature of the

orthodox industrialization strategy as applied to non-oil dependent capitalist countries. This strategy equates development with the creation of a high value-added industrial sector. To develop this sector, most developing countries rely upon the revenue from primary commodities exports to finance capital goods imports and oil. Inherent budget deficits and accumulated debt then force governments into the SAP policy regime in order to: maximize export revenue; ensure debt payment and access to new loans through both multilateral and private sources; and encourage private sector investment.

In an economy of surplus labor, such as the Dominican Republic, SAP fosters expansion of the size of the UIS in a number of ways. In the rural scenario, it perpetuates rural-urban migration through: low wages for domestic food producers; maintenance of an uneven land distribution system; and increasing the seasonal demand for labor. Under SAP, the public sector expels workers from the payroll and the government's capacity to create jobs through infrastructure programs is lessened. In the industrial sector, through policies which compress real wages and which restrict credit availability, SAP helps expand the size of the informal sector by inducing poverty and domestic recession.

Proponents of the missing middle concept clearly can identify this structural feature in the Dominican Republic.

However, blindness towards policies that promote imports of consumer and capital goods over domestic production, and discourage backward linkages between foreign and domestic firms means that simply transferring resources to help businesses grow will not be sufficient. Until policy changes occur that allow for a domestic industry to capture markets assistance is superficial.

Similarly, the neo-liberal theorization is inadequate in the Dominican context as shown in the decline of SME ownership in the early 1980's. Moreover, retrenching the state and increasing the role of market forces, as implemented in SAP, will not create employment or wealth for the majority because production is dominated by foreign companies producing for foreign markets which requires capital intensive production techniques and low wages. Until competitive advantages are seen as applying to the domestic consumer markets, retrenching the state can only mean perpetuating the existing system. The government has a definite role to play in stimulating a domestic manufacturing sector and in stimulating domestic demand.

Because of the Dominican government's firm application of SAP and disregard for direct policy intervention on behalf of the UIS, reorientation can only be initiated through political pressure. In the past the government has proven susceptible to such pressure. The tendency of the real minimum wage to rise suddenly and then gradually fall,

implies a reactive policy of socio-political crisis management. However, in this case, political pressure must not only be in regards to job creation and wages, but should also focus on the development of a larger domestic food industry, more equitable land reform, backward linkages with foreign industry, development of a domestic consumer durable goods industry. Without political pressure, it is certain that the administration will continue their historic pattern of development and dependence upon the US and the UIS will continue to grow, along with unemployment and poverty.

## Chapter 5. Evaluation of a Scaling-up Program: FONDOMICRO in the Dominican Republic

### I. Microenterprise support

What is notable about the Dominican Republic is that the private sector along with international donor agencies and PVO's have taken the overwhelming responsibility of developing, maintaining and supporting SME programs (See Culbertson, et.al., 1983). The Fundacion Desarrollo Dominicano (FDD) has operated for 25 years and ADEMI is portrayed in the literature as one of the most successful programs in Latin America. As well as these two, at least seven other smaller but none-the-less significant private sector programs exist extending credit and services throughout the country<sup>1</sup>.

During the economic crisis, and in spite of high inflation rates in the past few years, many programs have significantly expanded their portfolios in real terms and their outreach<sup>2</sup>. While this may be worthy of study in

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<sup>1</sup> Other programs include ADOPEM, IDDI, PROAPE, PROPE, ADEPE, ASPIRE, MUDE.

<sup>2</sup> ADEMI's 1990 annual report states that the year was the institution's most successful despite inflation of approximately 90 percent. This refutes the statement of Anne Beasley of USAID who upholds that the most significant contribution that governments can make to SME programs is to keep inflation rates low. Clearly the inflation rate makes a program more difficult to operate because of their need to recover costs, but a well managed program can cope with high rates. ADEMI's strategy in high inflationary times is to shorten the term of the loan and increase the interest rate. It also protected itself by increasing the percentage of commercial and service type businesses which have a high inelasticity of demand. The portfolio in 1985

itself, it could likely be explained by the increasing level of managerial expertise and technical support from international agencies, larger amounts of capital available and an expanding target group.

Success of these programs is tempered by the knowledge of their minimal impact at a national level. In 1989, the total number of loans disbursed through them, including agriculture, was 15,629. With an average loan term of approximately 9.1 months, this translates to about 11,730 clients nation wide (USAID 1989). When this is related to the increase in people entering the workforce annually or even the number of people that are within the target group, as stated earlier, the criticism of selective upliftment carries much weight.

The existence of a number of programs and the high degree of unmet demand for services provided the rationale for a scaling-up program (Fraser, 1991, p.2). The creation of FONDOMICRO, a second stage financial institution, is perceived as the solution to access more resources and provide the SME programs with better technical assistance which will allow them to intervene more effectively and with greater impact in creating employment and alleviating poverty.

At this point it is impossible to conclude how the

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was 89 percent manufacturing businesses, at the end of 1990, they represented 31.7 percent and commerce and services 58.3 percent, 9.9 percent were unclassified (See Boomgard 1989 p.33 and ADEMI 1991b p.24)

experiment will turn-out. FONDOMICRO made its first loan to a client in June of 1991 and has six years left in its proposed project life. At the end of that period it will be able to function without external support and continue to provide the same services to its clients. However by assessing its objectives, its structural components and also by assessing the progress of the existing programs, which will form the clientele of FONDOMICRO, it is possible to draw conclusions on the relevancy that the scaling-up process will have on the institutions that deliver services to the informal sector, and more importantly on the poverty alleviation and creation of employment.

## II. Evaluation criteria

Given the structural features that have created and perpetuated the informal sector in the Dominican Republic, the key aspect of the assessment of FONDOMICRO is its ability to produce changes in these structures. Without this capability, FONDOMICRO is simply a resource transfer program which can not be considered as a solution to poverty alleviation and job creation as it exists in the informal sector.

To make the evaluation, the institutional characteristics and components of FONDOMICRO will be examined. Institutional characteristics refer to the

objectives, level of demand, organizational structure and the operation criteria. Like SME programs, these are all relevant because they give insight into how the target market is determined and dictate how support will be given. In this case, it is particularly important because FONDOMICRO will be consolidating the in-flow and distribution of funding to SME programs. The characteristics also determine who is in control of the program and thereby allow an assessment on the likelihood of structural change. The assumption in this part is that internally induced models of reform are necessary to influence changes in public policy that will be beneficial.

The program components of FONDOMICRO: the criteria for borrowing, the technical assistance and its social component are all relevant to discuss because they will dictate the type of program design eligible to access the capital of FONDOMICRO, the type of technical assistance available and the capacity of FONDOMICRO to have a positive social impact. The important assumption made in evaluating the components is that a variety of SME program designs are necessary if all levels of the informal sector are to benefit.

Because the clients of FONDOMICRO are actually the SME programs that on-lend to the informal sector businesses, it is necessary to look at the impact of these programs have on job creation and poverty alleviation in the UIS. The final evaluation technique of FONDOMICRO is an assessment of



ADEMI, the only SME program which meets the criteria of FONDOMICRO and the SME program which others are encouraged to emulate.

### III. Institutional Characteristics of FONDOMICRO

#### A. Objectives

As stated in the project paper (AID/LAC/P-579), FONDOMICRO has been selected as a demonstration project of GEMINI's Action Research Program with two primary purposes. FONDOMICRO will solicit funds from international donors and distribute these funds to its clients; local NGO's involved in SME programs targeting the informal sector. It is estimated that by the seventh year it will have raised and disbursed over US\$30,000,000 (USAID, 1990, Annex C p.1). The target number of clients to be reached is 36,000 which will create an additional 30,000 permanent jobs (USAID, 1990, Annex D p.6 and Annex E p.5). The second purpose of FONDOMICRO is to provide technical assistance to programs so that they can upgrade their institutions in order to deliver services more efficiently. FONDOMICRO is also seen as the natural institution to advocate against public policy that discriminates against the informal sector, and suggest proper policy.

The benefit of this system comes from consolidating the funding sources for SME programs and the monitoring

requirements of donors. FONDOMICRO will replace a system where each SME program must spend time securing resources from different donor agencies and each donor must deal with a variety of small programs that is similarly cost-ineffective. Therefore very explicitly FONDOMICRO has been designed to centralize fund raising and distribution of capital at a national level.

#### B. Level of Demand

Demand for the program exists at two levels: the SME programs which will form the direct client base and SME operators who are the ultimate beneficiaries of increased resources, but indirect clients of FONDOMICRO. Table 5.1 shows the status of the direct clients operating in the Dominican Republic along with the projections of lending made for FONDOMICRO. This represents the supply of capital from FONDOMICRO compared to the SME programs' ability to distribute money.

Estimating the demand of indirect clients determines the quantity of resources necessary to develop a meaningful program. It also provides the quantitative standards on

Table 5.1 SME programs in the Dominican Republic  
as Sept. 1989.

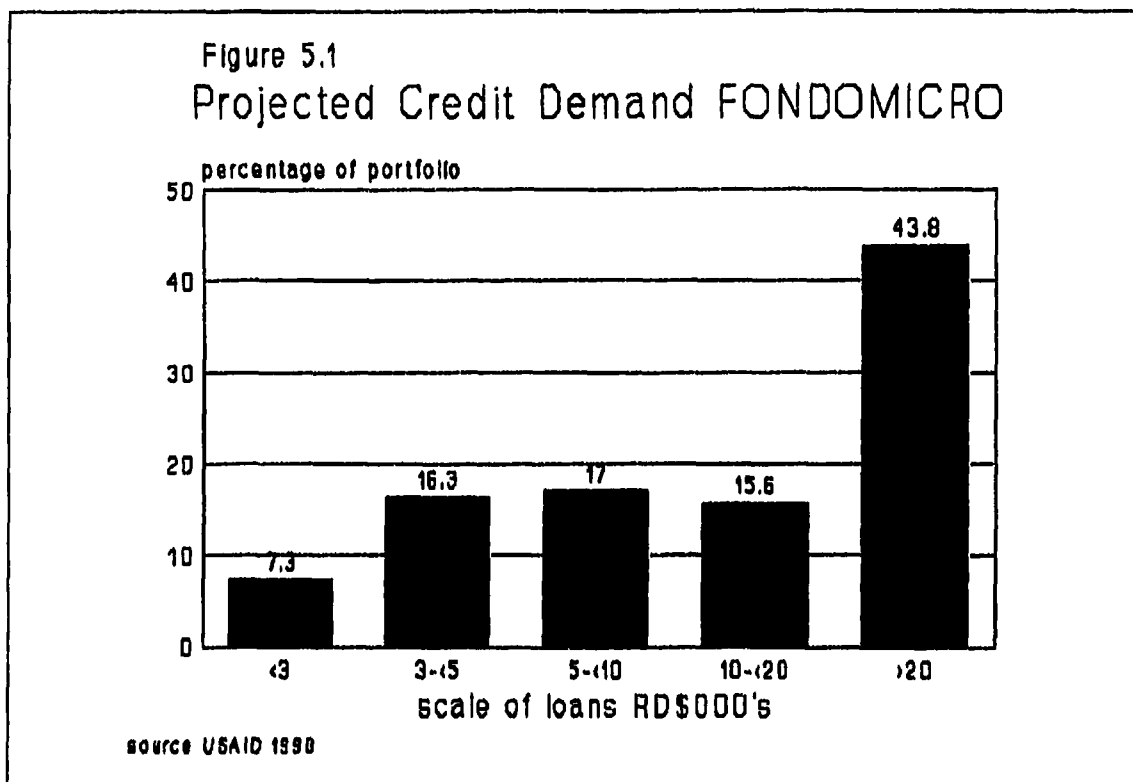
Organization	Portfolio RD\$	outstanding loans	avg. loan size RD\$	effective annual int. rate
ADEMI	10,750,000	4,300	2,500	81.84
ADOPEM				
sol group	500,000	300	1,667	63.50
microent.	1,800,000	900	2,000	71.30
FDD				
micro	400,000	78	5,128	61.70
DWHH (micro)	2,450,000	1,113	2,201	26.00
DWHH (camp)	1,050,000	356	2,949	na
Fdo Brugal	240,000	23	10,435	33.58
UVA	841,000	93	9,043	22.00
Emb. Can	69,080	7	na	26.00
MUDE	2,200,000	6,000	1,100	15.75
IDDI				
sol groups	300,000	60	5,000	80.80
micro	1,500,000	1,000	1,500	55.08
PROAPE				
sol group	125,839	88	1,430	45.76
micro	2,279,004	322	7,078	39.58
PROPE	30,000	10	3,000	78.97
ADEPE				
micro	782,722	579	3,863	35.60
small	2,236,493	200	3,914	35.60
ASPIRE	1,000,000	200	5,000	
TOTAL	28,554,138	15,629	1,827	
FONDOMICRO				
year 1	20,745,000	2	10,237,000	
year 2	34,125,000	4	8,531,250	
year 3	47,775,000	8	5,971,875	
year 4	75,075,000	10	7,507,500	
year 5	75,075,000	10	7,507,500	
year 6	75,075,000	12	6,256,250	
year 7	81,900,000	12	6,825,000	
TOTAL	409,500,000	58	7,060,345	

source: USAID 1989,1990

which impact assessment will be based. The target market in this case refers to businesses with the four following characteristics:

- are usually operated by their owners
- are usually unregistered and unlicensed
- have no access to the formal financial system
- have less than 50 employees (USAID, 1990 p.1)

In 1989, a study estimated the number of microenterprises in Santo Domingo and Santiago. It concluded that 145,000 microenterprises exist of which 78,000 are potential borrowers (MSI Study, 1989 p.14). The demand for credit as stated in the proposal paper of FONDOMICRO is shown in Figure 5.1.



### C. Organizational Structure

The national structure of scaling-up is a multi-institution decentralized model akin to the AGS in Colombia. FONDOMICRO exists as an apex institution for resources and information but a number of different NGO's actually provide services to the clients. It is therefore the NGO's that will scale-up their own activities with FONDOMICRO playing a supporting role.

The organizational structure is a hierarchical one with a General Assembly, a Board of Governors (see Table 5.2 for its composition) and an Executive Director in charge of daily affairs. There are three units within the organization: the Administration and Information unit is comprised of accounting, MIS and general services; the Financial Support Services which deals with the lending, follow-up and repayment activities; and the Client Services and Research is the third. In total it is estimated that 7-9 people will be employed in FONDOMICRO.

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Table 5.2 Board of Directors of FONDOMICRO

<u>Position</u>	<u>Name</u>	<u>Background</u>
President	A. Dauhajre	Leading economist, Executive Director of Fundacion Economia y Desarrollo Inc. A key figure in a major retailing/ merchandising business
1st V.P.	L.M. Achecar	President of the Association of Mortgage Banks; V.P. Financial Group of Banco Hipotecario Dominicano
2nd V.P.	P. Castillo	Senior partner Castillo y Castillo which specializes in banking law
Treasurer	L.T. Andujar	General Manager IBM; member of the Monetary Board of the Central Bank.
Secretary	P.A. Rodriguez	Past-president Banco Popular; V.P. of Banco Popular Financial Group
Director	C. Lluberes	Owner of Lineas Martimas, Representative for Cargill International, Deputy in National Congress; President of ADEMI
Director	V.E. Luna	C.E.O. Industrial Confitera Dominicana; ex-President Santiago Development Association; member of the Board of the Banco Poular Financial Group
Director	J. Vitienes	President Industria Lavador; President American Chamber of Commerce
Director	F. Rainieri	Leading tourism developer; past-President American Chamber of Commerce
Director	F.A. Najri	President of the Federation of Chambers of Commerce
not stated	L.A.G. Hernandez	President National Council of Businessmen

source: USAID, 1990 Annex C. p. 6-8

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#### D. Capitalization

The capital available for lending over the first seven years of FONDOMICRO is \$US33,288,200 which at the bank exchange rate for Oct. 1990 of 11.20 pesos per dollar means a lending portfolio of \$RD 399,458,400. The source of the funds are indicated in Table 5.3.

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Table 5.3 Source of Capital for FONDOMICRO  
Quantity (US\$)

Source	
USAID grant	3,500,000
GODR (STP) *	2,000,000
IDB	8,000,000
Bilateral Donors	2,500,000
Commercial Banks	14,000,000
FONDOMICRO	3,288,200
Total	33,288,200

\* Government of Dominican Republic (Technical Secretariat of the Presidency)

source: USAID, 1990 p.31

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#### E. FONDOMICRO's operating criteria

At the end of the program period, FONDOMICRO is expected to be able to cover all costs associated with its credit program and most of those associated with its technical assistance program. In order to do so FONDOMICRO will charge borrowers a fee for loans that will cover most of its costs associated with: borrowing money, developing and maintaining a credit base that allows it to borrow from commercial sources, bad debt reserve and administrative costs. The remaining costs will be made up through charging a fee to organizations for the technical services provided.

#### IV. Analysis of Institutional Factors

##### A. Objectives

The objectives of FONDOMICRO are valid. The economic crisis in the Dominican Republic is deep and programs that provide assistance to the informal sector are needed. This assistance takes on what appears as an integrated approach, providing new credit, technical assistance and social research which clearly is necessary.

However, the impact of FONDOMICRO can be questioned according to the target figures it sets for clients reached and new jobs created. After seven years to reach 36,000 clients and create 30,000 new jobs is insignificant when compared to the magnitude of the problem as outlined in chapter 3. These figures barely touch upon the level of job creation needed and ultimately show the futility of resource transfer programs. Thirty million dollars is a substantial amount but clearly money alone will not resolve the underlying problems of unfair macro-economic policies or unequal access to resources and markets. A single policy change in any of these areas would likely have greater impact on poverty and job creation than FONDOMICRO will have in its initial seven years.



## B. Level of Demand for Credit

### 1. direct clients

It is evident that FONDOMICRO intends to transfer a large amount of money to SME programs. As evidenced in Table 5.1, the average loan projected by FONDOMICRO to its clients is in all cases, except ADEMI, much larger than their active portfolios in 1989. It also projects two loans made in Year one, four in Year two and finally twelve in Year seven. There are not twelve SME programs in existence today in the Dominican Republic. New organizations will have to form and become clients, or the existing organizations will receive more than one loan per year, meaning that they will have to substantially increase their capacity to distribute money. In either case the projections are extremely optimistic and perhaps unrealistic. For this reason the success of FONDOMICRO will be contingent upon the effectiveness of the technical assistance offered to SME programs in upgrading the managerial and monitoring capabilities.

To ease some the pressure on the technical assistance component, FONDOMICRO estimates the average loan given will be roughly RD\$11,000. This is nearly 2.5 times the average loan size of ADEMI, which is similarly larger than all the other programs. Figure 5.1 showed that loans over RD\$20,000 will consume more than 45 percent of the portfolio. This indicates that the target market for FONDOMICRO is larger

individually operated businesses as opposed to the smaller one- and two-person businesses which dominate the UIS. FONDOMICRO is explicitly supporting intensive job creation as the solution to unemployment and poverty in the Dominican Republic.

## 2. indirect clients

The figures used to estimate the indirect demand for FONDOMICRO services can be criticized on two grounds: the definition used by the MSI survey underestimates the number of microenterprises existing, and FONDOMICRO uses an entirely different definition than the survey, so the estimated demand has little bearing on the target group of FONDOMICRO.

Defining the UIS to include businesses with fifty or less employees completely misrepresents the sector in the Latin American context as shown in chapter 1. Also, the other characteristics used to distinguish the UIS have less validity than the size distinction because they do not define a target group except in terms of lack of access to formal credit. As shown earlier, access to credit is a function of the macroeconomic policy environment and therefore cannot be a meaningful criteria of distinction.

In carrying out the MSI survey of microenterprises, two assumptions were made; microenterprises are located in specific areas of the city, and they are home based. These assumptions are not valid and serve to underestimate the

actual size of the informal sector (Reyes, 1989 p.9). Microenterprises exist in all neighbourhoods and are not necessarily located in the place of residence.

More fundamentally, because FONDOMICRO is targeting what it refers to as the informal small and microenterprise sector (ISME), the figures produced by the MSI study estimate one-half its target group: the microenterprises. The MSI study limited itself to estimating the number of businesses with ten employees or less. The target market for FONDOMICRO includes these same microenterprises, but also small enterprises defined as having up to fifty employees. Therefore, in this case, any claim of FONDOMICRO reaching a significant amount of the target group, if based on the MSI survey, would represent crude propaganda because of the lack of accurate base-line statistics, and knowledge of the blatant discrepancies between target groups identified by the MSI study and FONDOMICRO<sup>3</sup>.

#### C. Organizational Structure

At a national level there is little evidence to indicate which type of structure; multi or single institution is most effective. In this case the multi-institutional decentralized model recognizes the operation of many programs existing in the country.

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<sup>3</sup> To assume that this knowledge exists within USAID is not unreasonable because it was involved with both the MSI study and the design of FONDOMICRO.

The specific organizational structure of FONDOMICRO is ambiguous in that the project paper does not describe the composition of the General Assembly, the ultimate overseer of the program. It does however indicate that the Board of Directors is comprised of some of the most influential businessmen in the country. While this may have some advantages in attracting investment from internal and external sources, it limits the possibility that FONDOMICRO will lobby or advocate serious changes in public policy that will reduce or eliminate structural causes of the UIS. FONDOMICRO follows the traditional top-down approach to development that has been invalidated as beneficial to the poor.

This internal structure should be contrasted with the scaling-up efforts in Bolivia and Colombia. The Chief Operating Officer of Bancosol is currently the Executive Director of PRODEM<sup>4</sup>. PRODEM will also provide other mid-level managers to ensure representation of the development community and that financial matters do not completely overwhelm the objectives of the project. In Colombia the ultimate body in control of the process is the Assembly of Membership which is comprised of representatives of the local NGO's working in the SME sector. Scaling-up dictates a level of management further removed from the ultimate users of funds, but there are methodologies which serve to lessen

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<sup>4</sup> PRODEM is the largest NGO microenterprise program in Bolivia.

this distance.

In terms of the locus of control, FONDOMICRO carries on the Dominican tradition of dependence on the U.S. From conceptualization, to feasibility studies, to implementation and on-going operation of the project, USAID has had and will have intimate access in setting objectives and controlling policy over the life span of the project. This is guaranteed by the hiring of a Program Manager contracted by USAID to actively monitor and recommend changes within FONDOMICRO (see USAID, 1990 Annex C). This is even further emphasized by the fact that USAID will absorb the total cost of operations of FONDOMICRO for the first two operating years and that the money loaned by FONDOMICRO during this period will be the money granted to it by USAID. These represent large subsidies which will allow FONDOMICRO to accumulate its capital base quickly.

However this control can be overemphasized in the sense that the national elite, would have very likely constructed the program in exactly the same manner because of their ideological consistency with the USAID. Historically, they have advocated and benefitted from traditional development strategies. The members of the Board of Governors are some of the primary beneficiaries of these policies and it would be irrational to believe that they could conceive of anything other than a rent seeking, capitalist program which maintains the existing political economic structures. While

economic structures. While they are certainly benefitting from USAID's resources and technical expertise in the project period, their involvement in this program has financial advantages for their banks and also the possibility of personal and political prestige as they claim to be leading the fight against urban poverty.

#### D. Capitalization

The funding for the project is entirely from loans, grants or interest bearing certificates<sup>5</sup>. As earlier mentioned, FONDOMICRO does not have the capacity to capture client savings. Therefore it is foregoing a major source of low cost funds for reborrowing to other SME operators and is essentially transferring resources from the informal sector to the formal. Assuming that the program operates well, it will be a good investment for the participating commercial banks as an accumulated investment in FONDOMICRO of US\$14 million will provide access to the savings accumulated by the borrowers of US\$33.28 million over seven years.

Another problem identified is that the cost of money borrowed from FONDOMICRO is not competitive in two ways: due to the availability of large amounts of concessionary funding at this time; and successful SME programs can receive loans from commercial banks. The former is

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<sup>5</sup> The money contributed to the project by FONDOMICRO will be raised through the issuing of bonds or other investment certificates.

identified as one of the chief concerns of FONDOMICRO in the sense that if other donor agencies are willing to give money directly to SME programs at subsidized rates which are then passed on to the clients, FONDOMICRO will be undermined by the proportion of demand this credit services (See Fraser, 1991)<sup>6</sup>. While this is a legitimate concern, the major funders, USAID, IDB and the government, are backing FONDOMICRO and it is likely that any surpluses of subsidized credit will soon work their way out of the system as these organizations protect their investment and ensure that the model succeeds. In the second case, using non-concessionary funds means that FONDOMICRO will pass along its cost of capital plus its operating expenses to the SME programs, who will then on-lend to the clients at a rate that covers their expenses. Considering that successful programs like ADEMI and ADOPEM can access loans directly from commercial banks, receiving a loan from FONDOMICRO inflates the interest rate these programs charge by the percentage which FONDOMICRO adds to the loan to cover its operational expenses. Why ADEMI and ADOPEM would want to take FONDOMICRO loans is uncertain especially when high interest rates lower the profitability and capital accumulation of the end user.

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<sup>6</sup> This problem was confirmed during a conversation with K. Stearns of ACCION on Dec.5. She stated that there exists a large amount of subsidized credit in the Dominican Republic now that will make it very difficult for FONDOMICRO to find clients.

#### E. Operational criteria

Due to the pervasive control by USAID and the business elite, the objectives of FONDOMICRO stress the donor oriented issue of self-sufficiency over flexibility to meet the needs of the clients. This biases the program towards the expansion design which is more cost efficient. This limits the possibility of programs to become involved in legitimate social activities as stated in chapter 2 by Olivares. The diminishing of this possibility similarly diminishes the possibility of creating internally induced methods of reform.

At a project level, the emphasis on self-sufficiency and expansion model programs means that two organizations listed above as potential clients may not be eligible to receive loans. Both IDDI and MUDE are formation programs that take a holistic philosophy to SME support. It is not certain that they will meet the criteria of FONDOMICRO without fundamentally altering their program orientation. If they do not, this means an even greater burden on the existing organizations to expand and circulate the capital of FONDOMICRO. In 1985, Ashe used flexibility to meet the needs of clients as a sign of a successful institution. FONDOMICRO is not flexible, it is authoritarian.

#### V. Components of FONDOMICRO

The components of FONDOMICRO are based on those offered



clients, offering technical assistance to help strengthen the institutions that provide credit to SME's and researching the issues that can lead to better services or public policy (ADEMI 1991b p.53).

#### A. Criteria for borrowing

In addition to the criteria of being legally incorporated and having office space, servicing at least 200 people, FONDOMICRO requires that clients:

- a) must have an adequate and well-maintained accounting system that allows tracking of income expenditures, source and use of funds, a proper balance sheet, etc.
- b) must have an approach, philosophy and policy regarding credit consistent with that of FONDOMICRO
- c) must have and maintain good records on all aspects of their credit program. Their records must be such as to allow quick and reliable identification and assessment of problem loans, bad loans, overdue loans.
- d) which operate support programs other than, and in addition to its credit program, must have accounting procedures in place that allow for separate accounting of disbursements, costs, income, etc. related to its credit program, and disbursements, costs, incomes, etc. related to its other programs. It must have regulations and policies in place that call for loan repayments to be used first for meeting all costs associated with operation of the credit program (including maintenance of the organization's lending base) before any loan repayment revenues may be diverted for use in meeting costs associated with operation of the non-credit programs operated by the NGO.
- e) must charge a positive, real interest rate plus a spread to cover all costs it incurs in operating its credit program, plus bad debt reserve (USAID, 1990 Annex C p.25. Emphasis in original).

## B. Technical Assistance

The technical assistance component of FONDOMICRO will be vital to its success because of the injection of such a large amount of money into the NGO's and current status of most programs. Technical assistance is not actually offered by FONDOMICRO, rather it is contracted out to the GEMINI project of USAID. The primary focus of the technical assistance is to strengthen the institutional capacity of the organization as it relates to monitoring the portfolio, delivering credit, credit policy, interest rate structure and accounting. Organizations applying for loans will first undergo an assessment of their institution to determine whether they can meet the criteria as stated above. If they do not, GEMINI will require the appropriate structural or methodological changes in the organization that will be completed before loan approval.

## C. Research

This aspect is tied into the technical assistance package in that it will conduct research on organizations to help them upgrade to a level that qualifies for FONDOMICRO loans. However research will also be conducted on issues pertaining to the SME sector and the effectiveness of the organization as a whole.

## VI. Analysis of Components

### A. Criteria for borrowing

According to the criteria required by FONDOMICRO, non-revenue generating services are discriminated against. This is particularly evident in criteria (d) listed above. The separation of credit from training expenses is very difficult for those programs using the minimalist approach so training on a one-to-one manner will continue. The impact of this policy is to isolate training programs offered in formation and transformation designs which comprise distinct components of the programs. It will make these types of services virtually impossible due to requirements calling for loan repayment to cover all credit related expenses including inflation allowances and a bad debt reserve. This relates to Level 3 self-sufficiency. Very few minimalist programs have achieved this level and no formation or transformation program has. Therefore FONDOMICRO homogenizes SME program methodology to enterprise expansion design and thus limits the benefits to the type of clientele these programs reach.

### B. Technical Assistance

Due to the shortage of qualified clients, the technical assistance package offered by GEMINI is at this point the key ingredient in the success of the FONDOMICRO. GEMINI's

training program primarily deals with institutional strengthening in accounting and other reporting criteria. It will help upgrade SME programs to meet the criteria of accounting and reporting as dictated by FONDOMICRO's criteria, so that they can access the capital. The training program has no capacity to develop better training programs, training trainers, etc. and will therefore not help in strengthening the non-revenue generating services which would be very beneficial for both formation and transformation designs.

#### C. Research

FONDOMICRO has been assigned a role of researcher of issues, rather than advocator of change. Therefore the organization's active social responsibility is blunted while the academic edge sharpened. It implies, contrary to Bromley's critique reproduced in chapter 2, that substantial human and financial resources will be spent on further investigation into the successes and failures of the side-effects, while the disease located within the political and economic structures carries on unabated. Given who controls the program and the fact that it is a demonstration project, there is likely to be little critical research produced by this organization.

## VII. Progress of Clients

FONDOMICRO will likely be judged a success or failure based on its ability to on-lend its capital. However, it is not enough that the project disburse more than US\$30 million into SME sector, the reason for this program is to alleviate poverty and generate employment. The vehicle to attack these problems is local SME programs, more particularly, FONDOMICRO has chosen enterprise expansion design programs as the preferred tool. Because the success of FONDOMICRO relates to the success of these organizations, it is necessary to discuss the relationship between this program design and poverty alleviation and employment generation.

### A. ADEMI

ADEMI is the leading institution in the scaling-up effort in the Dominican Republic. Over its nine years of operation, ADEMI has earned the respect of the government of the Dominican Republic and the international community. It represented the government at the First International Congress of Microenterprise Programs held in Guatemala in 1989. In January 1990, it hosted the Second Congress in Santo Domingo. Furthermore in the 1990 World Development Report, ADEMI was one of a handful of organizations working in this particular area cited as contributing positively to the alleviation of poverty (World Development Report, 1990

p.57). Based on these successes and its ability to reach clients, cover costs and receive loans from private banks, ADEMI is the model which other programs are being encouraged to replicate<sup>7</sup>. It is possible to evaluate the impact of scaling-up process by evaluating the impact of ADEMI on the SME sector.

ADEMI was created in 1983 under the impetus of the PISCES program. The existing President and Executive Director as well as an expert from ACCION International created the objectives and program design:

- to strengthen the economic democracy of the country
- contribute to confronting the problem of unemployment and underemployment
- to promote employment for the most needy class so that through incomes and honest means they can elevate their standard of living and integrate themselves into the social and economic life in the community
- to serve as a bridge of contact and communication between the business community, the news media, the Central Government and its institutions and the lowest sectors of society and to work to elevate the living standard of the last
- to bring economic and technical assistance to the most people with as few resources as possible. (ADEMI 1990c).

Originally both solidarity group loans and individual group loans were available. However the solidarity group component was phased out by 1987. The reason for this move is inconclusive. Some cite the belief that solidarity groups

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<sup>7</sup> It has been suggested that ADEMI be subcontracted by the GEMINI project to do some of the technical training required by FONDOMICRO (See ADEMI, 1991 p.54)

constrain people from achieving and businesses from growing<sup>8</sup>. Others attribute the phasing out to the instability of lending to small vendors after the IMF austerity package in 1984<sup>9</sup>. Whether the reason was ideological or practical, the result is the same. ADEMI chose to shift its emphasis from the smallest businesses to larger ones as evidenced by the earlier statement of the Internal Executive Committee. At this point ADEMI became the prototype minimalist credit program.

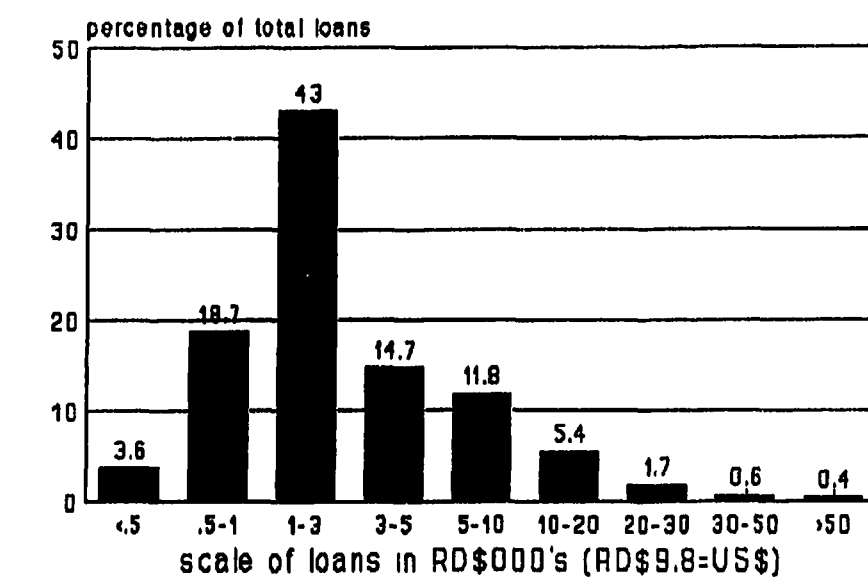
Figure 5.1 shows the percentage of loans made according to specified ranges for 1990. Further ADEMI statistics show that the average loan size during this year was RD\$4,300. Figure 5.2 gives greater insight into how the portfolio is distributed. It shows a highly skewed distribution to the upper end of the loan range. While loans above RD\$5000

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<sup>8</sup> This belief in the value of entrepreneurship was a reason cited by A. Saunders during interviews in Santo Domingo in May 1991.

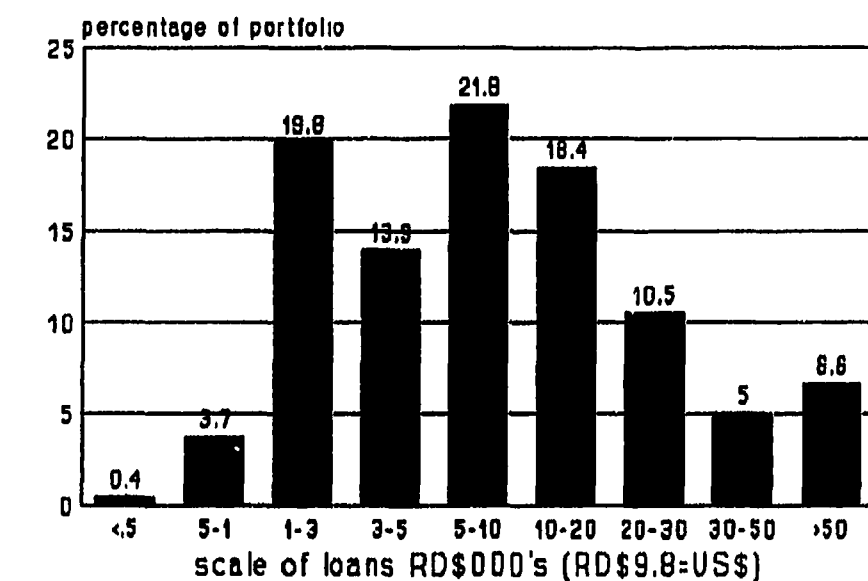
<sup>9</sup> Reichmann states that urban vendors and marginal businesses were hardest hit by the adjustment package and as a result many of the poorest left the city to find cheaper places to live or simply refused to repay loans. At that point the director and the Board decided to not continue to make loans to these people. (See Reichmann p.156 in Buvinic and Berger, 1989)

Figure 5.2  
% loans granted by scale ADEMI 1990



source: ADEMI report Feb. 1991.

Figure 5.3  
Distribution of Portfolio ADEMI 1990



source: ADEMI report Feb. 1990



accounted for 20 percent of loans made, they consumed 62.3 percent of the portfolio. In 1988, ADEMI records show loans greater than RD\$5000 represented 12 percent of the total loans but consumed 55 percent of the lending portfolio. Therefore the tendency is for both the number of large loans and the percentage of portfolio they consume to increase.

From the standpoint of ADEMI, the ability to make the larger loans is a function of an increasing lending portfolio (see Table 5.4) and the drive for self-sufficiency. In 1988 the largest ADEMI loan was RD\$40,000, which clearly could not have been conceived of in earlier years when the portfolio was much smaller. An increasing portfolio allows for larger loans which simultaneously increases profits and reduces pressure on the institution to expand personnel and administrative structures. The similar distribution patterns of both ADEMI's and FONDOMICRO's portfolio indicates this is the preferred distribution for the attainment of self-sufficiency and will be encouraged in the other organizations.

From the stand point of SME's, ADEMI is increasingly attractive because of the difficulty they have in receiving credit from formal sources. It is not only the fact that credit is being restricted due to SAP, but the

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Table 5.4

Growth of loans granted and credit portfolio  
as of Dec. 31, 1990 (\$RD)

period	1983-88	1989	1990
total amount loaned	32,459,454	24,874,849	36,001,243
credit portfolio	6,008,069	11,897,998	17,933,610

source: ADEMI, 1990a

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timeliness of formal credit makes it irrelevant for most businesses<sup>10</sup>. Contrary to formal credit institutions, ADEMI's portfolio is expanding and it can process a loan application in 72 hours from first contact (Saunders, 1991 p.4). Despite its relatively high interest rate, it should be noted that the informal moneylenders may charge more. In this sense ADEMI is an important source of capital for small businesses.

The success of ADEMI is normally translated through two sets of figures. The first set is the total amount of money lent and the level of recuperation, the second is the number of jobs created and strengthened. This is evidenced by an article in El Siglo, 3 May 1991 in which ADEMI was rebutting an article on the findings of a study which concluded that

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<sup>10</sup> The lag time from application to receiving money from private commercial banks ranges from 1 to 3 months. The estimation of time for commercial bank loans came through a discussion with Portocarrera of ADEMI, June 8, 1991.

SME programs are not meeting their objectives of elevating incomes and creating jobs for the poor. Prominently stated in the article were that over the life of the program RD\$107,932,566 had been lent, of which 99 percent has been recuperated and that 11,619 jobs have been created and 39,910 strengthened.<sup>11</sup>

There can be no doubt about the fact that minimalist programs like ADEMI that provide credit, are helping to create jobs and are valued greatly by those who participate in them. In the midst of a deep economic crisis like the Dominican Republic is in today, any organization that is providing credit to help finance small businesses is providing a valuable service. This service can increase the income of businesses supported and it may help create more employment. It is also true that demand for the service is increasing and that people will repay their loans. All these factors, plus the figures cited above point to the micro-success of SME programs. However, because of what is not known about the dynamics of the UIS and the inability to accurately measure it, there is no conclusive evidence that shows that the expansion of supported businesses or the income they generate is evolutionary growth.

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<sup>11</sup> This amount loaned figure is much larger than the capital base of the organization because loans are made very quickly, normally three per year sometimes four or even five. Therefore while an organization may have access to \$RD 10,000,000 because of the velocity that this money is lent and repaid, the ten million may become 30 or more. Under the same principle the almost 400 million peso capital base of Fondomicro means that potentially more than 1 billion pesos are available for lending if it is assumed that the length of lending remains the same.

On the other hand there is evidence that shows that the jobs created by businesses supported by ADEMI are not significant in terms of poverty alleviation and therefore fail at the macro-level. This is due to the pay structures set by the government and the inability of ADEMI to impact on this structure.

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Table 5.5 % Employees within salary ranges by occupation

Weekly Salary (RD\$)	Occupation						total
	1	2	3	4	5	6	
n.a.	7	5	5	0	0	0	3
<88-99	13	0	0	0	0	7	3
100-149	33	15	20	20	7	20	18
150-199	7	10	25	30	13	40	19
200-249	13	25	0	20	0	20	12
250-299	7	5	10	0	20	0	7
300-349	0	10	5	0	7	0	4
350-399	7	0	10	10	20	7	8
400-449	0	5	0	0	0	7	2
450-499	0	5	0	0	7	0	2
500-549	0	5	10	10	0	0	4
>549	13	15	15	10	27	0	13

1. Food production
2. Artesania
3. Mattress making/Upholstering
4. Clothes making
5. Cabinet making and carpentry
6. Shoe making and leather work

note: total does not equal 100 due to rounding.

source: Regino, 1990 p.64

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Table 5.5 gives an indication of the salary levels of six occupations in ADEMI's lending portfolio. These occupations were chosen because they are production activities and considered most likely to generate employment

and incomes by the assistentialists. According to the survey, 56 percent of all employees will make less than RD\$1,000 per month. By contrast, preliminary figures for 1990 show that the average monthly food basket cost RD\$2,139 (Sang Ben, 1991 p.6). Only 13 percent of those employed in these activities earn enough to satisfy these minimal needs.

Based on this evidence, it is unreasonable to suggest that SME programs which base their activities on intensive job creation in these activities are a means to alleviate poverty and create meaningful jobs in the UIS of the Dominican Republic. They do not address the issue of poverty because the jobs created cannot pay enough to maintain even a subsistence level. Any employment generated will have to be supplemented by other income earning activities. Therefore, informal activities will continue to expand at the self-employment level because this is the most flexible type of employment. The key aspect of poverty alleviation is a change in the wage structure of the economy which makes single employment sufficient to earn a living.

The failure of ADEMI and the other programs to impact on the structures that can ensure a livable minimum wage is evidenced by the governments lack of direct support to the SME sector and rigid adherence to SAP and all its detrimental impacts. The SME programs have not successfully engaged the system to the benefit of the poor, nor have they

actively encouraged organization of the poor, because they are part and parcel of that same system. Structural change is simply not a priority for most private sector SME programs in the Dominican Republic. Rather, the strategy is to simply transfer resources to the UIS and wait for a recovery in the global economy. Moreover, what appears central to the strategy of ADEMI and FONDOMICRO is the maintenance of those larger businesses that are being squeezed out from the commercial sources of credit in an effort to halt the decimating impact of Structural Adjustment Policies on this sector of the economy. This may be an important project to do exactly that, but it shows what a long way microenterprise support programs have come from their original conceptions as grassroots development and empowering initiatives in the case of the Dominican Republic.

#### VIII. Conclusions

In assessing the relevancy of FONDOMICRO to provide solutions to the structural problems of poverty and unemployment in the informal sector of the Dominican Republic, it is clear that the organizational characteristics, the program components and the favored delivery mechanism are all inadequate to induce the necessary changes. The organizational characteristics are based on theoretically weak premises of the causes of the

problems and leave the locus of control of FONDOMICRO squarely in the hands of those with a vested interest in maintaining the status-quo. The program components favor the minimalist approach, which not only represents a movement away from directly benefitting the poor, but perpetuates existing structures by not offering training and assistance. Similarly, the conception of social impact of the minimalist approach is located within the traditional paradigm of materialism. It completely ignores the political powerlessness which always accompanies poverty.

In fact, the model program, ADEMI, clearly states its intentions of working to support the present structures of the economy. Its belief that the intensive growth of production oriented firms is beneficial to the country, goes contrary to the evidence which suggests that the positions created are irrelevant to poverty alleviation and meaningful job creation.

By extension, FONDOMICRO is designed to support the existing macro-economic structure of SAP and global integration. It will not advocate for substantial change in policy that is necessary to stimulate the domestic economy and generate income at the lowest levels of the society. FONDOMICRO can provide assistance to the large scale business being squeezed from credit offered by the commercial sector, but it has little relevance to the vast majority of poor and self-employed people who work in the

informal sector. FONDOMICRO should therefore be viewed not as a poverty alleviation measure, but as an initiative designed to provide support to those businesses being squeezed from commercial credit sources due to SAP in order to stave off further deterioration of the small business sector.



## **Chapter 6. Conclusion**

Based on the evidence presented, the thesis statement: Due to impotence of FONDOMICRO to alter existing economic and political structures from the status-quo, it is irrelevant in resolving problems of poverty and unemployment in the urban informal sector in the Dominican Republic, has been shown to be correct. Rather, FONDOMICRO should be viewed primarily as an intervention supportive of SAP. It is designed to slow further deterioration of the SME sector by providing credit to larger businesses with the corollary effects of maintaining existing jobs and creating a marginal number of jobs.

In concluding on the current informal sector theories, it is apparent that under its current usage, the term informal sector should be regarded as a general economic category similar to industrial, service or agricultural, which refers to work which exists outside the regulatory capacity of the state.

The informal sector is accepted as widely heterogeneous and therefore the PREALC version is the dominant theory. However, because the theory of Heterogeneity combines both involutory and evolutionary principles it has no academic relevance. It is also detrimental because it serves to direct assistance away from the poorest of the poor toward larger businesses of the UIS as evidenced by the

assistentialist approach. Further studies of the informal sector require complete separation of the small and microenterprise segments of the UIS from the survival segment if they are to have relevance.

The dominance of the theory of Heterogeneity, is due to the lack of explanatory power of the other theories. The evolutionary theories which include: the assistentialists, and the neo-liberals are overly optimistic about the capacity of SME's to accumulate capital. The assistentialists show that some segments of the UIS can benefit from resource transfer, but they provide no evidence that the accumulation is in fact occurring in an evolutionary manner. The neo-liberal theory lacks an analysis of the political-economy of development by ignoring fundamental structural inequalities that exist in the economic sphere. Without addressing the existence of oligopoly markets, lack of backward linkages from TNC's, and continued displacement of the rural laborer, in the case of the Dominican Republic the market alone will not resolve the crisis of poverty and unemployment as it exists in the UIS.

Due to the structure of the UIS in the Dominican Republic and other Latin American countries, the evolutionary theories which include: the neo-marxist and the organizational restructuring approach, are better at explaining the realities of the UIS. With the vast majority of firms being the smallest enterprises, the evolutionary

theories correctly place the emphasis of their analysis on the conditions of these businesses.

However, the inflexibility of the neo-marxist approach to accept that some capital accumulation occurs among UIS businesses, does not correspond to the evidence which shows that both large and small informal businesses do exist in non-exploitative relations with the formal sector. The organizational restructuring theory at this time lacks the constructive side of its theory that will lead to resolutions of the problems within the UIS. None-the-less it is particularly interesting because it attempts to transcend the economistic conception of the other theories. The organizational restructuring theory will therefore provide the basis for fruitful investigation into the social and political implications of the informal sector. Now that the UIS encompasses the majority of voters in most countries, investigation into these areas are most relevant and should set the research agenda in the 1990's.

Despite the conceptual confusion of defining the informal sector, there is a virtual convergence between de Soto's writings on the right and in Bromley's and Portes's from the left. The convergence is based on the need for structural change. Few believe that resource transfer alone will benefit the UIS in the long-run. While both recognize the need for changing the economic structures, the difference between the neo-liberals and the involutionists

is that the latter call for changes in the political structures also. The evolutionists perceive the existing political framework as functioning adequately.

What is essentially at issue between the theories is the definition of democracy. The involutionists stress the inability of developing countries governments and certain groups of people to participate in developing alternative strategies of economic and political development. They therefore emphasize the dependent and subordinate nature of these countries and peoples. The neo-liberals, on the other hand, stress the existence of democratic elections as the single criteria of democracy. Given the historical circumstances of the Dominican Republic, the involutionary theories are better equipped to explain reality.

As a model of structural change, SAP, the externally induced model of reform is dominant in the political-economy of development today. This is due to its support from the industrialized nations, many developing country governments and most multilateral aid agencies. In explaining the informal sector, those who promote SAP follow the neo-liberal theory and hence the traditional development paradigm of modernization theory. However, it is apparent that SAP is not adequate in providing a solution to the UIS. As seen in the case of the Dominican Republic, SAP perpetuates the expansion of UIS and levels of poverty and unemployment within the society. Moreover, the

industrialization program advocated by SAP, creates marginal paying jobs that, in the Dominican Republic, do not provide sufficient income to meet basic requirements of sustaining an individual or family. For this reason, neo-liberal theory and SAP must be rejected as a development strategy aimed at resolving poverty and unemployment within the UIS.

In reviewing the development of private sector small- and micro-enterprise programs, it is apparent that these are relatively new interventions designed to alleviate poverty and unemployment in the UIS. While being much more efficient than earlier attempts, their inability to significantly impact these problems initiated the process of scaling-up.

Three designs of SME programs exist with each specifically suited to the needs of a particular level of client. Effective assistance to the UIS, will require that all three designs be incorporated into aid efforts. Enterprise formation programs reach the poorest and take a holistic approach to development. They offer a variety of services including training, community education and social promotion. Enterprise expansion programs reach established businesses and emphasize credit as opposed to non-revenue generating services. They are commonly referred to as minimalist credit. Enterprise transformation programs deal with the largest businesses and attempt to graduate them to the formal sector through training in management and production techniques.

Because all programs are reliant on subsidies from aid agencies, they are periodically evaluated. Impact evaluation of the different program designs is normally done through comparative analysis of economically quantifiable criteria such as: institutional self-sufficiency, income generated by clients, and jobs created and strengthened. These are poor evaluation measures because they are biased towards the minimalist approach. In the case of self-sufficiency, it disregards the different cost structures that arise from offering non-revenue generating services like training and social empowerment. Similarly, jobs created and strengthened criteria are biased towards larger capitalist oriented businesses and finally, income generated by clients cannot be precisely measured by evaluators. Overall bias in evaluating programs has led all funding in the scaling-up process in Latin America to be directed into enterprise expansion style programs. This is detrimental to UIS assistance because it means that only one type of business is being supported in the scaling-up process.

Future evaluation of SME programs should not be done on an inter-design comparative basis. Rather, each design should be evaluated according to its own objectives and capability to reach the target clientele with the services needed. This would ensure that all designs would continue to receive donor support, and would also facilitate experimentation with different delivery methodologies for

non-revenue services and evaluation techniques that can extend beyond the bounds of traditional economic measurement. Effectiveness of programs could be evaluated on a intra-design comparison in order to determine the most efficient service delivery methodologies for a particular program design.

Assessment of FONDOMICRO reveals that it is more a stop-gap measure than a serious commitment to UIS assistance. In nominal terms, the over US\$30 million it will raise over seven years is significant but the goals of acquiring 36,000 clients and creating 30,000 new jobs, over the same period, pales in comparison to levels of unemployment and poverty that exist in the country. Furthermore, its organizational structure inextricably ties FONDOMICRO to the interests of USAID and the elite class, which means that it will not be a significant institution in promoting structural reforms other than SAP.

FONDOMICRO can also be criticized for being an inefficient intervention because it opts for financial intermediation over becoming a financial institution. This has advantages in terms of ease of operation, but minimizes the resources available for on-lending. By not capturing savings of SME operators, FONDOMICRO effectively transfers resources to the formal sector. Financial intermediation may also result in a higher interest rate to the end user because its access to subsidized or low cost capital is less

than a financial institution.

Evaluation of the program components of FONDOMICRO show that they revolve around the delivery of credit and accountability of the client. The criteria for borrowing and the technical assistance offered are biased towards the minimalist credit approach and therefore virtually exclude the formation and transformation designs from benefitting. This distances FONDOMICRO from directly benefitting the poor, except through intensive job creation. However, given the wage structure that exists in the Dominican Republic, it is illogical to believe that intensive job creation is the answer to poverty alleviation. Single waged employment is irrelevant for the vast majority of people because it does not provide income sufficient to purchase the basic monthly food basket.

The emergence of FONDOMICRO as a demonstration program presents some lessons for other countries moving towards scaling-up. Firstly, programs firmly in control of the donor agencies and elite class will not be responsive to the underlying structural issues that have created and perpetuated poverty and unemployment in the UIS. Secondly, the accumulation and transfer of significant resources to the UIS is not in itself sufficient to begin to resolve these problems. Programs that function exclusively within the criteria of institutional self-sufficiency and support the minimalist approach, will provide assistance to larger



businesses that are unable to access formal sector credit, but they will not help the majority of the poor. Similarly, they also will not impact on the political structure of the country which is another large part of the impoverishment of people.

If scaling-up is to be attempted, the best methodology to adopt is that of the full-fledged financial institution. While this costs more in the short-term, it ensures sustainability and allows for independence from donor influences that can allow the programs to take on greater technical and social impact roles. In this way the holistic package of assistance can be offered and possible resolutions to economic and political inequality may be found.

#### Concluding Remarks

Without fundamental changes in the way the industrialized nations view development it is extremely unlikely that developing nations will be able to extricate themselves from the crisis of poverty and unemployment that exists within their societies. This is because the industrialized countries control both the agencies that donate money and the agencies which lend it. If Canadians vote for a government that imposes neo-liberal solutions on

the domestic economy, it should be no surprise that the foreign aid given or supported by Canada is attached to the same principles. What is questionable is the relevancy which these policies have to the creation of an equitable, peaceful and tolerant society, or a world which respects cultural diversity and helps the disadvantaged.

SME programs do have a place in alleviating poverty and unemployment in the UIS of developing countries. The point of this thesis is that scaling-up should not lose sight of the causes and solutions of the problems. The majority of the poverty and unemployment in the informal sector, at least in the case of Dominican Republic, is due to structural inequities of the economic and political systems. Therefore poverty cannot only be seen in its economic form, it is also related to political powerlessness. It must be the aim of development workers to educate both individuals and governments about this reality and assist in implementing programs that foster political empowerment.

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