

Economic Restructuring in Latin America: Towards the Promotion of Small-Scale Industry

Harald Fuhr

The Problem: Debt and Development

The development decade of the 1980s will end like the decade before: the results of multilateral, bilateral, and national development efforts will very likely be disappointing in most LDCs — at least for the majority of the rural and urban population. Overall indebtedness will be more than \$1,000 bn, one third of which will be in Latin America, especially in Argentina, Brazil and Mexico. Only a few jobs have been generated in the formal sector of these economies and the future looks even more cloudy. Recent estimates show that, even under optimistic assumptions, some countries are likely to find themselves in 1990 with a per capita GDP barely exceeding the level of 1970 (Argentina, Chile, Peru) or lower (Bolivia). The prospects for Mexico, Venezuela and Colombia seem rather disadvantageous; Brazil will possibly be the only positive exception on the continent.

The external factors which facilitated industrialisation and rapid GDP growth in the 1960s and early 1970s are no longer working. World trade is not expanding rapidly; prospects for primary commodities are unfavourable. Real interest rates — particularly set against low export prices — continue to be high, as does the negative transfer of financial resources out of Latin America. The problems are aggravated by a tendency towards stagnating resources for development in the industrialised countries, and a severe criticism of both international organisations and national governments for their inefficiency in executing development programmes and projects [IBRD 1986a:6; IDB 1986:39].

The twin crisis of debt and development nevertheless may — like other crises often do — have positive effects and thus may also provoke a deeper reflection and discussion on the alternatives of development financing and cooperation.

¹ This article summarises some basic ideas of a research project undertaken at the University of Konstanz in the Federal Republic of Germany. Research on 'International Organisations, National Development Administrations, and Small-Scale Industrial Promotion in LDCs' is conducted by H. Elsenhans and includes four case studies on small-scale industrial development in Africa and Latin America [for a discussion of the research outline, see Fuhr 1985]. Research collaborators are B. Jessen, B. Späth, and P. Traça Assuncao.

The main thesis advanced here is that the promotion of small-scale industry [SSI] under readjusted circumstances and integrated into a more inward and market-oriented development strategy will be of outstanding importance in such an alternative approach. SSI, which in the past decade was most successful in creating new jobs and using economic opportunities in marginalised urban and rural areas, also seems to be advantageous for most LDCs in matching their crucial development problems of unemployment, underemployment, polarised distribution of incomes, shrinking foreign exchange, rural-urban migration and decentralisation.

One pre-requisite however will be a redefinition of public sector activities, which up to now have hindered this sector historically, politically and economically. Traditional supporting and lending programmes towards SSI have to take into account these mostly political obstacles and have thus to be reoriented. Rural and urban SSIs may then be able to contribute to a more balanced and stable 'bottom-up' growth of these economies.

In the following sections we will draw attention, first, to the predominance of large-scale agricultural and industrial enterprises and the role of the state in Latin America's industrialisation. This leads us to discuss the contradictory nature of state policies towards SSI. Peru and Ecuador will then provide some empirical evidence of actual approaches to support SSI, whereby the role of development administration will be highlighted.

Development Policies have Historically Favoured Large-Scale Enterprises and the Growth of the Public Sector

The discussion of the effectiveness of small-scale enterprises in urban as well as rural areas of LDCs goes back to the 1950s, when, for example, Indian government agencies pointed out several advantages of SSI, especially for the generation of employment, decentralisation and a more equal distribution of income [Snodgrass 1979]. These very optimistic assumptions, however, in most cases did not reflect the various obstacles to or limitations of SSI-development, especially when public agencies themselves tried to manage their promotion.

Past development decades up to the end of the 1970s have mainly favoured large-scale agricultural and industrial enterprises and have decisively contributed to the increase in the public sector's role in the economy. The expansion of state-owned corporations, particularly in Latin America, was usually justified with the argument of overcoming capital-market deficiencies and the sluggishness of private entrepreneurship [Sheahan 1976:206-10]. Earlier theoretical concerns that lack of entrepreneurship would prove a serious barrier to economic development [Hirschman 1958:24-28] have, however, as numerous studies show [e.g. Evans 1979], turned out to be much exaggerated. The Newly Industrialising Countries [NICs] in Latin America are striking evidence that a new mode of promoting economic growth has been taking place. This overall process was not solely achieved by mere 'economic groups' [Leff 1978] such as transnational corporations and large state corporations in Brazil and Mexico; the past decades have contributed significantly to the formation and extension of state-classes, dominating 'bureaucratic development societies' [Elsenhans 1981, 1985].

State-classes appropriate and allocate economic surplus by administrative means (instead of, for example, market competition). The control of the most important part of economic surplus by these state-classes gives them predominance over any other competing class, e.g. managers of multinational corporations, local entrepreneurs, peasants or workers. State-classes enter alliances with other classes in the form of clientelistic control over certain key instruments of such classes, normally in the form of state-dominated organisations (e.g. official unions). State-classes have emerged because there are investible funds, which capitalists cannot invest due to the structure of the local price system, which is itself the result of structural heterogeneity [Elsenhans 1985].

Such state-classes are quite different from their oligarchic predecessors, because — not being controlled by the market mechanism — they can make investment decisions linked to development goals to be attained in the future. But there is no mechanism which forces them to do so.

The often criticised inefficiencies of development administrations are to be explained by the internal mechanisms of state-classes. Contrary to Western types of 'rational' administration which have more or less room for manoeuvre, and which more or less rationally execute externally set policies, this dominant class has to set itself policies and priorities and to organise itself in order to achieve such priorities. Comparable to the rule whereby a free market entrepreneur seeks to maximise profit, members of the state-class seek to increase their prestige, their influence, and their income. They usually try to achieve these goals by forming coalitions. Such

coalitions can be based on common background, ideology or agency affiliation, or on family ties. In any specific case the interpretation of common interest is influenced by the particular interests of these rival coalitions, which tend to be rather stable and which can hence be called state 'segments'.

Previous development strategies promoted by state-classes have been characterised by the import of Western technology in order to create either state-owned or foreign-owned large-scale industry. Interests in both donor and recipient countries have largely favoured this process. Development assistance in the industrialised countries has historically been based on the idea of transferring modern technology and channelling financial resources into large-scale units, thus speeding-up the process of industrialisation and modernisation, even in the hinterland. LDC administrations tended to be seen as almost neutral instruments, capable of achieving any development goals, as long as foreign exchange is available. State-classes, on the other hand, could appropriate income from exports, and the most productive use of scarce foreign exchange was usually seen as the purchase of the best-performing technology in relation to cost. Hence, there was no interest in the promotion of intermediate technology, where the performance-cost-relation is normally lower. Best-performing technology is linked to large-scale enterprises. This behaviour is clearly detectable not only in industry; modern agriculture in LDCs, especially on plantations, has shown the same tendency.

State-classes tend to control development policy by investment plans, which allow them to centralise financial resources. Investment plans are first and foremost spending plans. They may be accompanied by production plans, but this part of planning depends on aleatory conditions. Because it is at least intended that production targets should also be met, state-classes tend to concentrate on large-scale industry, because it seems more easy to control such units, instead of a multitude of small-scale units, which are often unknown to planners.

There is an underlying rationale behind the excessive concentration on large-scale projects and the creation of 'white elephants': most of these projects are typically associated with the formation of powerful pressure groups interested in their implementation. Such groups usually include consulting and contracting firms, as well as national and international suppliers on one side, and directly involved segments of the state-class in ministries and agencies on the other side. These pressure groups develop in close relation with the corresponding segment of the local bureaucracy, which in its turn derives power and resources from the implementation of the project, and also with dominant political forces, who seek to capitalise on the political benefits of the investment.

For all these sectors, the attractiveness of a project is a direct function of its size [Portocarrero 1982:450]. The likelihood of receiving economic or political benefits is higher in large-scale projects and enterprises than in small-scale ones.

From Large-Scale to Small-Scale Enterprises

Given the facts that, first, any development project and strategy has to be implemented by development administration in LDCs; and, second, that such administrations are not neutral instruments in the hands of modernising elites, but (compared to developed countries) highly autonomous executive agencies of segments of state-classes; and, third, that the above mentioned causes favour the prioritisation of large-scale enterprises, there generally seems to be limited interest in LDCs in promoting small-scale enterprises.

However, the behaviour of state-classes is contradictory in regard to small entrepreneurs, especially in private industry. At least three major shifts at the international and national levels have contributed to a change in the importance of this sector:

1. Since the beginning of the 1970s, there has been increasing concern that neither private nor state-owned large-scale industry had brought forth the desired results. In particular, the distributional effects of this type of industrialisation were criticised as being of marginal or no benefit to the growing population of urban and rural poor. 'Redistribution with growth', small farmers' development programmes, urban development projects, and finally the promotion of small enterprises/industries were the outcome of these concerns. More generally, there was a shift from larger to smaller projects, from macro to micro levels of development planning in several international organisations [Gold 1976]. At the same time, the budgets of these organisations were shrinking.
2. Inside LDCs, the 1970s have brought parallel shifts in the composition of state-classes. New segments were rising, old segments disappearing due to severe reproduction crises particularly in the NICs of Latin America. The legitimacy of governments was questioned in several countries. They were accused of not having achieved their promised economic and social goals; protest movements surged, which later fuelled the 're-democratisation process' in Latin America; and growing foreign debt limited the funds and possibilities of muddling through.
3. In various LDCs the small-scale industry [SSI] sector was indirectly favoured by the deficiencies and inefficiencies of both the public sector and large-scale industry. This sector grew significantly

along with informal sector activities in the past decade. The Peruvian example may be illustrative in this respect:

- In the public sector, income was generated for which originally planned production did not exist. Markets for consumer goods industries increased through the government's concentration on large-scale industry, which did not achieve production targets.
- Since original production targets were not achieved, the planned linkages between different units of large-scale industry were not met and this sector consequently had to address itself to small-scale producers.
- Additionally, the concentration of the public sector on basic goods industry made intermediate products available for small-scale producers, who further elaborated them into goods for protected internal markets.
- There is ample evidence that SSI and the informal sector in Peru have grown enormously since the mid-1970s; they have contributed clearly to the creation of new employment (while large-scale industry decreased its numbers of employees); they used locally produced goods to a higher extent than large enterprises, and have already taken over large shares of the production of consumer goods, intermediate goods and even capital goods [Villarán de la Puente 1985:138-41].
- Parallel to the rising importance of SSI, there were growing organisational efforts by small entrepreneurs' associations, which, in the case of Ecuador for example, have already gained a relatively high degree of homogeneity and a powerful status. The 'Cámara de Pequeña Industria' was able to reduce minimum wages in SSI, and to receive tax exemptions/reductions in several areas of production [Pita 1985:238].

These processes of indirect promotion of SSI worked well as long as the state-classes had financial resources which could be used for conspicuous consumption and (even inefficient) investments. In the current situation of stagnating or decreasing foreign exchange earnings and high debt-repayments, enforced austerity makes this type of indirect promotion of SSI no longer practicable. On the other hand, new forms of promotion have been arising. Due to austerity policies, import restrictions and devaluations, the cost disadvantages of small-scale industries in relation to imports disappear, mainly because imported goods are no longer 'subsidised' by unrealistically high exchange rates. Cost disadvantages in relation to large-scale industry disappear, as the latter depends to a larger extent than SSI on imported and now more expensive goods. Moreover, government policies

officially switched to the promotion of SSI in order to balance reduced earnings from abroad by increased production at home, which must in part come from smaller enterprises.

Parallel to the often mentioned structural changes and shifts in development planning, international organisations have increasingly turned their attention to SSI. Since the World Bank's decision in the mid-1970s to support this sector via extensive lending programmes, the Bank has spent almost \$3,000 mn on Small Scale Enterprises [SSE], of which about \$1,600 mn has gone to Latin America, and \$800 mn to East Asia and the Pacific. Up to 1986 there were about 100 projects dealing with SSI directly or via development finance companies [IBRD 1986b:156]. Up to the mid-1970s only 0.5 per cent of total lending had gone to SSE; during the mid-1980s this amount increased to about 4 per cent, with a sharp increase from an average annual amount of \$100 mn [1976-79] to \$673 mn in 1984. (Since then there has been a drop in SSE lending, down to \$276 mn in 1986.)

The United Nations Development Programme has also increased its funds for SSI, mainly through its specialised agencies UNIDO and ILO. Though overall statistics are not yet completed, the figures for *one* important subsector, rural small-scale industry, are available. Since the late 1960s, UNDP has funded 642 projects, with a total budget of \$277 mn. The figures exclude projects solely based in larger urban areas.

The German Kreditanstalt für Wiederaufbau, which may be an example of bilateral development cooperation, had spent by 1985 more than \$1,000 mn for development finance companies, of which about 20 per cent concerned small-scale industry.

Despite the importance SSI has gained in both LDCs and international organisations, there are several obstacles to be overcome before a further breakthrough in the sector's development can be achieved. Though LDC governments welcome SSI programmes and projects verbally, when it comes to action, there is considerable evidence that government-led promotion fails to meet the basic interests of small entrepreneurs. Most of these obstacles tend to be political-administrative rather than economic or financial. The internal structure of LDCs and bureaucratic developmentalism hinders SSI in many ways.

Since administrations in LDCs historically were introduced by foreign powers to dominate regional or local authorities, and were more likely to control, tax and oppress small business than promote it, entrepreneurs are very aware of government agencies and programmes. This is even more accentuated when, as in the Andean countries, there are sharp socio-cultural differences between administrators and rural entrepreneurs.

The requirements for inscription and registration —

that is, to formalise small business — are numerous; bureaucratic procedures are usually lengthy and tortuous. The Peruvian government has recently tried to alleviate these administrative burdens, but the interests of the different ministries involved are contradictory and hard to satisfy. The institutions built up to assist small entrepreneurs (still particularly important for UNIDO technical cooperation) very often lack adequate management and staffing. Civil service rotation and political considerations are usually more important than managerial talent or relevant experience in SSI development. Since turnover in LDCs administration is rapid, there is little incentive to implement well-designed programmes. Motivation is often low because there is little to demonstrate and less to 'win' in supporting small entrepreneurs. Moreover, suitably qualified technical staff are difficult to recruit because outside (private) opportunities are often financially more attractive. Clientelistic coalition building and unequal treatment of small entrepreneurs thus becomes prevalent, with already privileged entrepreneurs receiving priority attention. Administrative headquarters in larger cities tend to be overstaffed, while regional or local offices lack technical or managerial skills.

Industrial estates, especially when these are designed to 'help' small enterprises in a nursery approach, have had little advantages for these enterprises. Due to the location of the 'parks' outside urban centres and local markets of raw materials, these often have severe infrastructural deficiencies (electricity, transportation, sewage, telephone services). Costly parks are thus underutilised unless they specialise in specific branches, or larger private firms give additional incentives [Goderez 1985:13-15].

Turning to financial assistance, one outstanding problem in Latin America has been the strong tendency for both development and commercial banks to focus on the main industrialised areas, i.e. metropolitan areas. State-owned banks often have a quantitatively more advantageous structure in this case, but their bureaucratic procedures are also more complicated and lengthy. Bank staff in more remote areas often have little autonomy to deal with the specific requirements of their clients. They usually have to consult their central offices to gain authorisation for most of their operations, but the process is impeded by poor communications within the network.

State-owned and (particularly) commercial banks' interest in SSI is often limited by their awareness of the high administrative costs in lending to smaller units, and the lack of securities on the part of entrepreneurs. Moreover, there is a common perception that the default-rate of SSI credits (compared to large-scale) is high, and debt collection is particularly risky and messy. In the Ecuadorian case, however, attractive

'spreads' for SSI operations have shown initial success and helped the banks to get into the area.

Besides state and private actors, an analysis of the political environment of SSI promotion also has to include small entrepreneurs' organisations. The difference between Peru and Ecuador in this respect is striking. While Ecuadorian small entrepreneurs successfully organised themselves during the late 1970s, and consequently formed a relatively homogeneous pressure group, the Peruvian scene is still much more chaotic. Peruvian small industrial entrepreneurs are still grappling with their organisations; personal rivalries and clientelism are rife and, up to now, have impeded the development of integrated and effective articulation of interests against legislation which favours the SSI sector in several ways, while their Peruvian counterparts still have a lot of work to do.

In sum, these kinds of problems demonstrate the importance of political and administrative obstacles to SSI-promotion, and lead us to be sceptical about the role of the state in this field. The key issue is that the public sector will not be able to change its attitudes towards SSI, unless it changes itself first, and limits its activism significantly. There is ample evidence that entrepreneurship is hardly favoured by administrative action, and, historically, has developed in contradiction with state-led industrialisation in Latin America. Public agencies may be more efficient when geared into more indirect assistance. This may only be possible in a more decentralised structure where participation by entrepreneurs is more likely to occur.

This does not mean that governments have to get out of the business. One necessary task is rather to analyse critically the degree of direct and indirect involvement of government agencies in SSI-promotion. We agree with Fishlow's conclusion [1985:145] that 'the mood in the region is not in favour of development strategies that preclude a state role, but leans rather towards reconstruction of an effective developmental state . . . The days of the former alliance between foreign capital, domestic capital, and state technocracy are finished. New bonds of cooperation between the state and productive sectors, capital as well as labour, have to be forged. New bounds for state presence have to be defined, even as a restored ability to generate a public surplus must be found.'

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