SMALL FIRMS AND THE INFORMAL SECTOR IN REGION OF PEJA

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Abstract
Although the development of a new private sector is generally considered crucial to economic transition, there has been relatively little empirical research on the determinants of startup firm Growth. These days, everybody loves small firms and their clusters–donors large and small, governments and Nongovernment organizations, left and right. Some characterize small firms (SFs) as the proper subject of social policy and safety nets, and house SF programs in departments of social welfare or labor. Others see SFs as the stuff of "serious" economic development, and focus on upgrading their collective efficiency, productivity, and market access. Unfortunately, the combination of the social-policy view with the inevitable local politics of SFs generates a brew that inadvertently undermines not only the upgrading agenda, but certain aspects of the social-policy agenda itself–namely, better environmental, labor and health-and-safety practices and protections. This article explains how this happens, and shows that things don't always need to turn out that way, especially if donors and others pay attention to the histories lying behind today's thriving SF clusters in developing countries.
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Introduction

The term 'informal sector' is used in this paper to refer to 'market-based production of goods and services, whether legal or illegal, that escapes detection in the official estimates of GDP[448]

Although the importance of small startup companies for economic growth and innovation is widely recognized in all types of economies—developed, developing, and transitional—there has been relatively little research into the policy-relevant factors that stimulate their growth. Studies of managerial opinions concerning the obstacles faced by their firms are useful and suggestive Over the last decade or so, myriad programs, projects, and policy reforms have focused attention on informal-sector (IS) firms and small firms (SFs) in general, as part of a broader social-policy agenda of reducing poverty and unemployment. Despite this welcome attention, many planners in developing countries nevertheless continue to view SF/IS programs as "only" welfare, rather than the stuff of "serious" economic development. The particular form taken by SF/IS support in many countries reinforces this view, as does the way SF/IS support is often embedded in politics. This jeopardizes certain benefits, ironically, that we hold crucial to the current agenda of reducing poverty and unemployment: greater observance by firms of environmental and labor regulations, sustained increases in efficiency and productivity in local economies and, as a result, improvement in the quantity and quality of jobs.

Everybody seems to love small firms. Whether big donors or small, bilateral or multilateral. Whether left or right, government or nongovernment, practitioners or academics, myself included. Small firms have even gained a prestigious place in the firmament of social policy, where microcredit and other small-firm programs are seen as forming a safety net into which the poor can gently fall. But this is exactly where the trouble begins, and that's what this article is about.

Small firms and the government

After reading about cases in other countries, I came to interpret what I was observing as a kind of unspoken deal between politicians and their constituents–myriad small-firm owners, many in the informal sector. If you vote for me, according to this exchange, I won't collect taxes from you; I won't make you comply with other tax, environmental, or labor regulations; and I will keep the police and inspectors from harassing you. I call this tacit understanding "the devil's deal[449]" because it causes informality to become *more* attractive, and formalization *less* attractive, than they otherwise might be. Once the deal is made, it is difficult for either side to get out of it. In certain ways, then, the devil's deal can pose just as significant a barrier to formalization and upgrading of small-firm clusters as the actual costs themselves of formalization and regulation. Much of the policy advice on this subject, however, focuses on the "burdens" themselves as the source of the problem–particularly, the costs of formalizing and observing tax, environmental, and labor codes. It advocates reforms, in turn, that grant special relief from these burdens to small firms in the form of exemptions from or reductions of taxes and other costs associated with environmental and labor regulation. In addition, the SF literature is strangely silent on the politics in which SF support is so firmly embedded.[450]

Small firms and the economy

The dynamic of the devil's deal also reinforces the distinctly dismissive attitudes held by many economic-development planners and by development-bank managers toward smaller and informal-sector firms. To the extent that these managers and civil servants acknowledge the importance of SF/IS assistance, they often view it as a "welfare" measure that belongs in "social"

[448]This is similar to the definition of Rampersad (1987) who, in a study of Trinidad and Tobago, defines the informal sector as that section of the economy which is: (a) not recorded in the official statistics, (b) not legal, and (c) not taxed. She further sub-divides the sector into a 'visible' informal sector, an 'invisible' informal sector (that part of the informal sector which covers illicit and socially disvalued activities) and a domestic sector

[449] Judith Tendler, Small Firms, the Informal Sector, and the Devil's Deal

[450] John Cross' *Informal Politics: Street Vendors and the State in Mexico City* (Stanford, California: Stanford University Press, 1998);

rather than economic- development agencies–in ministries or departments of labor or social welfare, or special small-firm agencies. In their eyes, SF support will help mop up the unemployment resulting from the necessary reforms and initiatives meant to restructure the economy and institutions of government for a trade-liberalized world. In these terms, the SF sector becomes mainly an instrument for preserving and even creating *jobs*–albeit often poor-quality jobs in poor-quality firms–rather than as an opportunity to stimulate economic development. This frees policymakers to dedicate their economic development attention elsewhere, by reducing for them the political cost of the job losses that ensue from the modernization of industry and economic-policy reforms. From this perspective, and more generally, SF-assistance programs do the important work of helping to maintain the "social peace," rather than necessarily to modernize the local economy.[451] Contributing to this same perspective, many international donors and non-government organizations couch their current support for IS/SF assistance, such as micro-credit and other programs, in terms of "safety-net" measures for poverty reduction. The devil's deal offers more to IS/SF clusters than just looking the other way from their violation of regulations. Governments often grant small firms a particular kind of support in which there is something for everyone–special lines of cheap credit, blanket credit amnesties when times are bad, and blanket exemptions for small firms from certain taxes and regulations.

The exemptions are "burden-relieving" in that they reduce the costs of small firms (or keep them from increasing) in a way that requires no effort on their part. They are also "universalist" or "distributive" in that they benefit *all* small firms–whether they want to grow or not, whether they are seeking to improve their efficiency or not, and regardless of sector. In maximizing the number of satisfied constituents, this kind of support to small firms is ideal for maintaining and increasing electoral loyalty. It is less than ideal, however, for stimulating local economic development that is sustained and employment-enhancing. Today, that is, the most widely agreed-upon forms of public support for local economic development do not have this universalist and burden-relieving character. In some ways, in fact, they are just the *opposite*. They strategically identify and try to remove bottlenecks to improved efficiency, productivity, and marketing for the sector as a whole. Before any significant support is rendered, they often require or elicit broad involvement of the sector in a process of discovering exactly what the problem is and what to do about it. And they may benefit directly–at least at first–only those firms most capable and most interested in upgrading their production which, in turn, often leads to the latter's formalization. The histories of dynamic small-firm clusters often reveal this particular kind of strategic public support which, in turn, has been central to the formation of strong local economies and the reduction of unemployment. Once the "devil's deal" has been made between firms and politicians, it becomes politically awkward for governments to carry out the above-mentioned strategic and sector specific support because it does not automatically benefit all small firms. To the extent that it does benefit the region as a whole–as in the breaking of important infrastructure bottlenecks or the linking of local producers to outside buyers through trade fairs–the benefits may be longer in coming and more diffuse, and their effects may be felt by many firms only indirectly. These traits are just the opposite of those characterizing the relief provided by the burden-reducing exemptions and subsidies–immediate, automatic, universal, conspicuous, and directly available to each firm as an individual unit. Classifying firms by their size (small, medium, or large) for purposes of public policy, rather than by their product or sector, reinforces the tendencies toward the burden-reducing approach. "Small," that is, can encompass a quite diverse set of firms–rustic and sophisticated, producing in different sectors, and located in different places. But the kind of support that best fits the size denominator is the burden-reducing subsidies and exemptions because of, their universal and distributive benefits. That is why we often find small-firm associations pressing more for the universalist exemptions than for the strategic supports. In this sense, then, size is also the *lowest* common denominator, in that its associated subsidies and exemptions are the least likely to lead to sustained development No one would deny the importance of SF associationalism in the histories of many dynamic clusters. Organizing and lobbying according to firm size, moreover, may be the only way small firms can hope to compete with larger and more powerful firms for the attention of policymakers. At the same time, the attention paid by governments and donors to firms according to their (small) size–and to small-firm associationalism–can also work inadvertently in the same direction as the devil's deal. The large volume of research on small firms and their clusters does not tell us much about the circumstances under which universalist concerns and demands will dominate strategic ones in SF associations, let alone the sequence by which universalist concerns and their burdenrelieving support sometimes miraculously give way to more strategic episodes. Complicating the story, the two approaches may coexist within the same association.[452]

Focusing on the difficulties small and informal firms face in meeting the costs of environmental and labor standards distracts our attention from pursuing opportunities for firms

[451] Suzanne Berger and Michael Piore (Cambridge: Cambridge University Press, 1980), Chapter 4, pp. 88-131.

[452] "Trainers by Design: Small Firm Upgrading and Inter-Firm Learning in Jalisco, Mexico," Ph.D. dissertation, Department of Urban Studies and Planning, Massachusetts Institute of Technology, 2002 (forthcoming).

to, indeed, rise to the occasion and meet these standards, rather than be exempt from them.

Though we are used to thinking that SFs need protection from these “excessively” burdensome costs, there are many cases in which SFs have actually met those costs and, contrary to the burden-relieving scenario, have been better off for it. They became more efficient, produced higher quality goods, and gained new access to more demanding markets.

The histories will also provide insights into the sequences of events and other circumstances under which local actors make the transition from burden-relieving to more strategic and transformative deeds. Showing that such outcomes are perfectly imaginable, and familiarizing planners with the felicitous outcomes of actual cases and the paths that led to them, might also contribute toward reducing the generalized antipathy in the economic-development sector of many countries toward the enactment or enforcement of environmental and labor standards.

Conclusions

The policy sympathy for small firms as a category of assistance, in sum, is desirable on many grounds. At the same time, the concern about protecting SFs from reasonable regulations– let alone from the vicissitudes of the market–can become toxic when combined with the political dynamics of the devil’s deal. The waiving of tax, labor, and environmental regulations that results from sympathy for small firms may hinder rather than help local economies if it condemns them to low-level economic stagnation, degradation of the environment, and violation of worker rights. The latter all clearly increase unemployment and poverty, as well as burdening unnecessarily the task of poverty-reducing social policy.

Literature

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