

FEATURE ARTICLE Issue 46

Contracting MSEs for Pro-poor PPPs in Latin America

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Abstract:

This article focuses on the beneficial role pro-poor PPPs serve in supporting micro and small enterprises (MSEs) in developing countries. The advantages of contracting with MSEs are numerous and largely center on providing employment and services to the most vulnerable. This is demonstrated with an example of municipal procurement in Peru. However, the existence of pro-poor PPPs is limited by constraints both in the willingness of the public sector to modify contracting procedures and the ability to MSEs to comply with often prohibitory rules and regulations. Solutions to such barriers are found in Bolivia where a “compro Bolivian”=buy Bolivian, decree has increased MSE contracting through measures such as lowering contract guarantee amounts and information fairs to advertise contracting opportunities to MSEs. The article concludes by iterating the important impact pro-poor PPPs can have on MSEs and more broadly developing fostering local economic development.

1. Pro poor contracting in Latin America

This article will outline how pro-poor PPPs¹ can be used to improve the employment opportunities and livelihoods of people in micro and small enterprises (MSEs²) at the local level. In most developing countries MSEs provide the biggest share of employment and those employed by these enterprises often represent the poorest segment of the population. At the same time MSEs deliver essential goods and services to the ‘poor’. Often MSEs provide public services in a private manner because otherwise these services would not be available. This article exemplifies how local governments can do more in order to buy from and to contract out to micro and small enterprises for public procurement and service delivery.

Contracting out to MSEs does have several economic and developmental advantages:

- Smaller enterprises are usually more employment intensive than bigger companies and provide employment where it is mostly needed.
- Contracting out to MSEs has a direct impact on the poor as the poor work in MSEs.
- MSEs spent their money locally and as such have a bigger effect on the local economy than bigger companies.
- MSEs do often already provide a service or produce the needed products, often little is needed to improve the provision of services or goods.
- The market opportunities created by public procurement have the double effect of supplying better services to the poor while at the same time providing incentives for local MSEs to grow and to improve their productivity.

¹ The term PPP as it is used here refers to all activities in which private sector providers provide public services and goods, mostly contracted by the public side (so it does not cover all types of PPPs). Other terms used for this type of services provision is Private Sector Participation (PSP) and when coming from the enterprise development side: public market access for MSEs

² The term MSE is understood as including any entrepreneurial activity (also survivalist) of self-employed entrepreneurs up to enterprises of 49 workers.

Several local and national governments have already taken a wide range of steps in order to make public procurement more accessible to MSEs including local governments in the UK and national governments in Chile and Perú³.

The example of the city of Cajamarca in Perú provides a strong case for the benefits of contracting MSEs. In 2004 the ILO commissioned a study (Yeng 2004b) about the procurement system of the city. Cajamarca, a city of approximately 120.000 inhabitants in the Peruvian Andes, is home to the biggest Goldmine in Perú, exploited by the Minera Yanacocha. The tax income generated by this mine has led to a relatively well off municipal government that has made efforts to reach out to local MSEs. One of the measures taken was the early publication of the municipal acquisition plan and its publication in local newspapers so that MSEs could prepare for the public bidding in advance.

The ILO study looked at municipal procurement in the year 2002 and found that a total of 53% of the local budget was used to buy from local MSEs (Yeng 2004b, page 34). Based on the budgetary figures and on the assumption that 18% of the amount of infrastructure contracts is spent for labour costs the study estimated that these contracts generated more than 30.000 workdays. Translating these into full employment this would mean that the direct employment impact of the amounts contracted out to MSEs was estimated as being 129 jobs a year, benefiting more than a 100 families.

However in many countries procurement systems are still not open to MSEs and a wide range of problems make the contracting out to MSEs difficult. That is why this article first looks at the constraints faced by local governments and small entrepreneurs in the process of public procurement. It does then showcase how the Bolivian government assisted by local and international agencies improved the procurement system in a way that might be especially useful for low-income countries.

2. The constraints for contracting out to MSEs in pro poor PPPs

For public contracts to take place between local governments and MSEs usually two issues have to be addressed: (i) capacity on the public sector side to adapt the regulatory environment to the possibilities of local MSEs and (ii) capacities on the MSE side to comply with rules and regulations. Through a study on the regulatory system in three Andean countries (ILO 2003) the ILO identified the main problem areas for the access of MSEs to public contracts in the regulatory environment:

- Bidding sizes: categories of bidding in procurement that provide access to MSEs are often too small to provide long term solutions. The usual public contracting system foresees different rules depending on the size of the contract. The lower the financial amount of the contracts, the lower the access barriers. The lowest (up to ca. 20.000 US\$ in Perú) category is most accessible to MSEs, but often the amounts are not high enough for service contracts that would run during a whole year.
- Bidding procedures and information. Complicated bidding procedures and important information gaps concerning these procedures create access barriers for MSEs
- State providers need to be certified in most cases and the requirements for this certification are usually burdensome and difficult to fulfil for most MSEs.
- The contract guarantees needed⁴ for public contracts often cannot be paid by MSEs due to lack of access to credit and other sources of finance

³ The finance ministry of Chile, that runs an internet based procurement system called ChileCompra³ (www.chilecompra.cl). Perú has an internet based procurement system handled by the national MSE agency PromPYME³ (www.prompyme.gob.pe). In the UK a recent study shows how several local governments have been buying from local suppliers (Sacks 2005) and the positive effect this had on the local economy.

- Often the costs for simple enterprise registration at local and national level are already so burdensome in time and money that they represent market entry barriers for MSEs⁵

Unfortunately local governments, especially in small municipalities, often face further constraints:

- In many countries the legal system is too slow and/or too costly, that it becomes difficult to enforce contracts, especially if the contracted MSEs are not legally registered companies.
- Often contracts are connected with some form of corruption of local authorities, a change in contracting rules might affect vested interests
- Local authorities often mistrust the MSE sector. The local government often has a bad relationship with street traders, this is often extended to other types of MSEs
- Often there is little information about the existing offer of local suppliers in the hands of local governments
- Municipal governments feel that they will not have the necessary capacity to manage a high number of contracts with MSEs
- The political will of the local authorities to promote employment and fight poverty is not always evident.

However, many of these constraints do also hamper traditional procurement systems. On the other hand also the small scale private sector has weaknesses that need to be addressed:

- Contract fulfillment on the municipal side is crucial for MSEs: If the municipality does not pay for a contract an MSE is executing this could be threatening the existence of the enterprise. It would be difficult for the MSE to enforce the contract because the legal system is very slow and legal processes are very expensive
- Low levels of education of MSE owners often restrict the participation in public biddings due to “legal illiteracy” and information gaps
- Due to a chronic scarcity of finance in most MSEs, owners and operators find it hard to access enough working capital to execute their contracts. The problem gets bigger if they have to come up with contract guarantees up-front
- The informality under which entrepreneurs operate restricts their access to public contracts
- Also the private sector mistrusts local authorities and often does not see the local authorities as allies. Due to their little access to services like finance and BDS also the quality of MSE production and service delivery is restricted.

3. A possible solution: Pro poor municipal procurement in El Alto-Bolivia

With the assistance of several international agencies (including the IADB and SDC financed Swisscontact) the Bolivian government devised a range of instruments to make public procurement accessible to MSEs. On the public sector side the “Compro Boliviano” (= buy Bolivian) decree was enacted. The decree lowers the contracting requisites for Bolivian enterprises and increases the transparency of public purchasing. It also presses on local and

⁴ Guarantees often constitute up to 10% of the contract value. The guarantee has to be paid upfront to the local government. This is a financial rule used to ensure that the contract will be fulfilled. Once the contract has been executed, the guarantee is returned to the enterprise

⁵ The “Doing Business report” of the World Bank found that registering an enterprise in Bolivia takes 67 working days and more than 1500 US\$. The average GNP per capita in Bolivia is 900 US\$/year. These numbers are worse for many African countries. For details on Bolivia see: <http://www.doingbusiness.org/Documents/Starting-Business/25.pdf>

national governments to buy more from local MSEs and lowers the contract guarantees and the required experience for Bolivian enterprises by 50%.

In order to make it possible for MSEs to access these new opportunities the government introduced the “tarjeta empresarial” (= entrepreneurial card) as an instrument to “formalize” individual entrepreneurs to gain access to public procurement. The “Tarjeta Empresarial” establishes legal liability for contracts up to 1.000.000 Bolivianos (123.760 US\$) and can be acquired by any entrepreneur that is able to provide simple documentation⁶.

In order to make these new instruments known, the government started a promotion campaign of the “Compro Boliviano” through TV and radio. This was assisted by a group of donors that created a TV series in the popular “telenovela” (a Latin American soap opera) format. In the telenovela the microentrepreneur “Doña Rosita” overcomes a series of obstacles (including a corrupt municipal officer) in order to have access to the local procurement of school breakfast under the “Compro Boliviano”.

One of the problems that were found for the implementation of the new decree was that local governments didn't have the necessary know how to implement the “Compro Boliviano”. While being familiar with the “old way” of public contracting, they didn't know how to reach out to a larger MSE population while at the same time ensuring that public works would be executed with the required quality.

That is why PROCAL, a private vocational training institution developed the “Feria a la Inversa” (= inverse fair) as an instrument to implement the “Compro Boliviano” using the “tarjeta empresarial”. The fair is called “inverse” because it is a buyers fair: The municipal government presents with models and specifications everything it wants to buy from local MSEs including infrastructure and services up to an amount of 1 mil. Bolivianos. The presentation is done on a fair ground and every municipal project or purchase is exposed on a different stand which can be visited by local MSEs. On the second day of the fair MSEs can bid for the contracts and the procurement decisions are taken by a technical committee of the municipality on that same day. The process of exposition and direct acquisition makes corruption (a common problem in public contracts in Bolivia) more difficult, ensuring a higher transparency of the procurement practice.

The first “Feria a la Inversa” took place in EL Alto, the sister town of Bolivia's capital La Paz. EL Alto (800.000 inh.) is one of Bolivia's fastest growing cities and arguably the poorest one. The first fair (in which only a small part of the municipal budget was exposed on a pilot basis) resulted in more than 30 contracts with local MSEs for a total contracting amount of 1,3 mio. US\$. Through the fair local MSEs gained access to public markets and at the same time provided public works and services. The municipal government as well as the local MSEs needed training before the fair could take place. The municipal government technicians were assisted in revising the budget and identifying those parts of the budget that could be contracted out and in writing the needed terms of reference. All local MSEs that demanded it could get a short training course on how to bid for public contracts once they had acquired the “tarjeta empresarial”. The training provided and the technical assistance had a cost of approximately 100.000 US\$ because it was partly delivered by international consultants. However, this cost was more than compensated by the lower cost of services that resulted out of the fair. The municipal budget allocated for the works was 300.000 US\$ higher than the actual contracted sum.

4. Conclusions

The instruments developed in Bolivia for pro-poor PPPs show that procurement can be a powerful tool to create employment and provide services, but challenges remain for most countries. The examples of Perú and Bolivia show that:

⁶ A personal ID-card, documents that prove that the enterprise has been in existence for more than a year (bills, accounting records, etc.) and, a sketch of the location of the enterprise that can be verified

- Simplified procedures for public contracting are necessary for both local governments and MSEs. However, public procurement is usually regulated at the national level. Legal reforms need to take place at national level.
- Another problem that needs to be addressed is an often slow working and expensive legal system. Due to this legal system, contract enforcement is a problem both for municipal governments as well as MSEs.
- In the future it will be necessary to build in compliance with labour rights as a precondition to contracting out public works and services. This could also have the additional positive effect of playing an exemplary role of how the state drives the formalization of MSEs in a positive way (by offering contracts instead of enforcing).
- Crucial to the possibility of contracting out is also the local enabling business environment. If the costs of complying with local regulations are very high and do yield little for MSEs their willingness to comply will be low. Simplifying regulations would probably lead to higher compliance and to higher incomes for local governments through taxes
- But legal and regulatory changes need to be accompanied by the necessary capacities to apply these changes:
- There is a need to build capacities in local governments but also in MSEs, so that both parties can meet on a level playing field
- Related to this capacity building is the question about how to finance this capacity building in a sustainable manner. The example of El Alto shows that it could be economically viable
- One of the problems that is often found is that there is little trust between local governments and local MSEs. An effort needs to be made for local governments better to understand the reality of informal sector enterprises and for MSEs to better understand the restrictions and constraints under which local governments operate. Transparency in contracting (like e.g. with the "Feria a la inversa") can help to overcome these obstacles.

But there are not only technical decisions to consider for pro-poor contracts and PPPs that can benefit the poor. A necessary starting point for employment creation and poverty alleviation is a political decision and political will at the local and national government level to apply these types of policies and instruments.

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