Enabling Growth and Promoting Equity in the Global Financial Crisis Risk and Vulnerability: A view from COPLA works on SMEs

Introduction: Changing in Growth but not in equity

Central America has seen a positive growth rate from 1990 to 2008; however, poverty rates and inequality have barely changed. According to UNDP (2002), Nicaragua has a high income concentration with a Gini index (measuring inequality) of 0.56[1], which is similar to that of Guatemala (0.6), Honduras (0.55) and El Salvador (0.53). However, the National Statistics Institute (2004) calculates the Gini index at 0.43, which is lower than Costa Rica (0.46), a country with lower poverty levels and strong redistribution policies in the areas of education and health.

In the case of Nicaragua, the richest 10% of the Nicaraguan population has increased its share of total income from 42.4% in 1993 to 46.1% (an annual growth of 0.46%) and is expected to have increased its share again in the 2005 survey where 60 % of population was responsible for 31.2 % of total consumption, while top 20 % for 47.2 %, and the top 10 % for 31.7 % of consumption. The richest are concentrating income at a higher rate, thus demonstrating that the redistribution policies are not accomplishing their goals. The poor population (excluding those living in extreme poverty), which represents around 40% of the total population, has seen a drop in its share from 24.8% to 22.9% and the non-poor population has also suffered a reduction from 27.5% to 24.8%. In other words, wealth has been transferred from the middle income strata to the wealthiest and extremely poor population. It is expected that in the long term highly mobile and vulnerable middle-income families will be absorbed into the poor and extremely poor families.

According to the National Institute of Statistics and Census (INEC) (2007), poverty rate increased from 45.1 to 47.2 (two percentage points) which means that 36,204 became poor between 2001 and 2007. Extreme poverty was reduced from 16.2 to 16 % (0.2 percentage points), in absolute numbers means that in same period 3,718 families became extreme poor. It is possible to say that poverty has a rural face in Nicaragua. Around 70.3 % of the rural population living under the US$2 a day poverty line and 30.5 % below the US$1 poverty line. Rural poverty and extreme poverty are linked to the tropical dry zone where crop production is vulnerable to rainfall declines and employment options are very limited. Important clusters of rural landless families are gathered around labor intensive systems such as coffee, banana and sugar cane cultivation. However, Nicaragua has one of the lowest agricultural wages in Central America, around US$1.43 a day (CEPAL, 2006), which is below the US$2 a day poverty line and close to the extreme poverty line, meaning that the system itself will continue to maintain the poverty levels. It is clear that Nicaragua will not be able to reduce poverty significantly - 70.3 % of rural population below poverty line and 30.5 % below extreme poverty line.

[1] The third highest income concentration rate in the world.

Table 1. Nicaragua: Official statistic on Poverty using relative and absolute numbers

Year	Poverty Rate	Extreme Poverty Rate	Total Population	Population under Poverty Line	Population under Extreme Poverty	Balance on Poverty	Balance on Extreme Poverty
1993	50.3	19.4	4,174,900	2,099,975	809,931		
1998	47.9	17.3	4,560,526	2,184,492	788,971	84,517	-20,960
2001	45.8	15.1	4,801,251	2,198,973	724,989	14,481	-63,982
2003	45.1	16.2	4,968,753	2,240,907	804,149	41,934	79,160
2005	47.1	16.0	5,142,098	2,421,928	822,736	181,021	18,587

Grigsby and Perez, 2007 based on INEC 2002, 2007 and UNDP 2002.

Vulnerability: Internal Factors

Before and after the global financial crisis, small and medium enterprises (whether rural or urban) will face vulnerabilities associated with their own characteristics. They depend on familiar labor as main asset and in some cases they hire workers. Enterprise's size goes from 2 to 10 total workers. They are spread in multiple activities such as furniture, artisans, services, internal trade, food, thus organization and representativeness is quite challenge. In order to generate a common agenda, they agree on general issues that no one appropriates as his/her own agenda. (Romero, 2008)

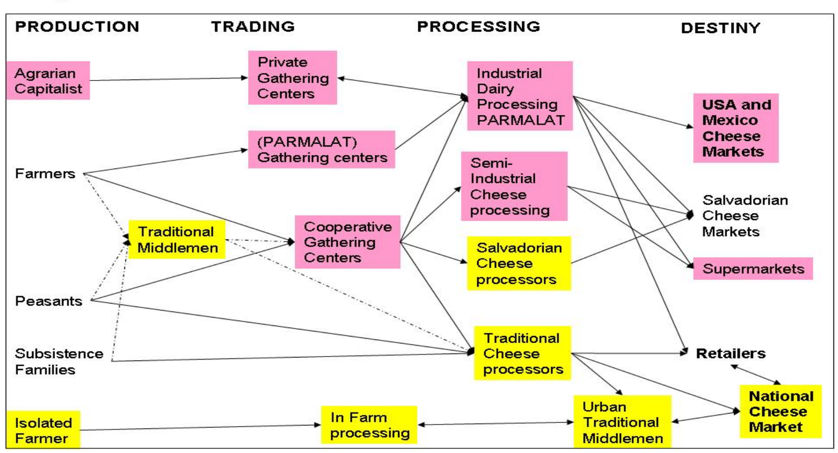
As a firm, small urban and rural enterprises face challenges. The first is their small scale production - they demand small quantities of inputs, so they are linked to a long retail chain, which also tends to be expensive. At the same, their production volumes do not allow them to establish contract with large distribution firms. Cash flow management is the second key challenge. Small enterprises need to move their capital as fast as they can. They cannot offer credit program to clients, because they will face liquidity problems. As result, if a client is going to buy a product, she will have to pay the totality in cash. This makes purchasing from large wholesalers more attractive, as they offer small payments in long term credit plans to clients. Consequently, SMEs are linked with local markers selling cheap products with low quality. Finally, politics play a key role on dispersion and preventing collective actions, since SMEs are aligned with a political party will not be part of an organization with members of other political view. (Perez, et al 2008 and Romero, 2008b)

Vulnerability: Rules of engagement

Trade policies (internal and external trade) are key elements to set the domestic rules of engagement. Since monopoly is a permitted practice at domestic markets, large firms tends to control input and distribution markets, forcing product supplier to sell at low prices and consumers to buy at high prices. According to Grigsby and Perez (2007) after 1990, the agricultural input market has been controlled. For example, an oligopoly imports and distributes 70 % of seeds, fertilizers and pesticides. Nitrogenous fertilizers and pesticides are the main intermediate imports for agriculture. Financial markets are developed with commercial banks and micro-finances institutions with approximately US$ 220 million in agriculture loans, covering between 15 and 20 % of producers. However, credits are mainly for short term and with interest rate higher than 25 %. The new Government is having a public intervention on rural finances market, but the implementation process is not clear.

Urban SMEs are facing similar issues: Nicaragua has a single flour importer, thus small bakeries should be more competitive (lower prices to consumers), but they only have an option for buying key inputs (Romero & Lorio, 2009). Wal-mart is becoming the key retailer in Central America. It is even competing with traditional retailers in traditional market. Small retailers should offer products with lower prices or specific characteristics in order to compete (Grigsby & Perez, 2008). Wood (timber) is controlled by a small group which exports timber. Nicaragua barely processes wood and exports furniture. Most of furniture processors are small enterprises with 5 to ten workers. As result SMEs in the wood sector are linked to domestic markets. Similar case with cheese transformation (Please see Figure below), yellow tags represent low and price value chains where SMEs as located, while pink labels represent high quality standards and prices with Parmalat as leader.

Agro-Industrial Chain of Cheese: rural families and commercial circuits



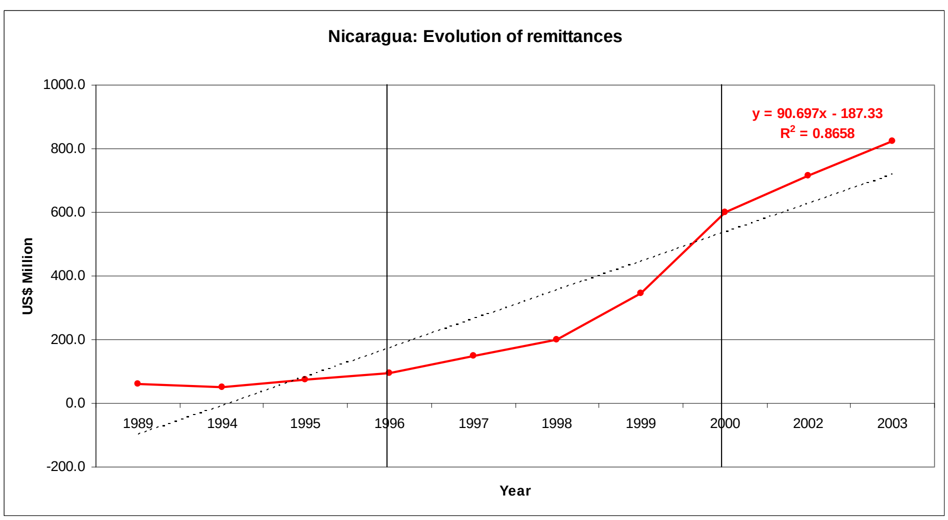
Grisby & Perez, 2006

Risk: Financial Crisis

Central America is going to be affected by the global financial crisis by several ways: exports, unemployment and decrease of remittances. Agricultural exporter countries in Latin American are facing effects from a decrease in consumption level in importing countries such as USA and EU. Key products are reducing their total export such as: seafood, meat, coffee, sugar, etc. As result, a higher unemployment rate in rural areas is expected. With a reduction of textiles industries (maquila), urban areas are also likely to face rising unemployment.

Decrease of employment in key Developed countries such as USA, Spain and Costa Rica (Tourism based economy) will affect migrants and remittances. Decrease of remittances, will affect consumption of product and services in developing countries such as Mexico, El Salvador, Honduras, Guatemala, Nicaragua, Ecuador and Bolivia.

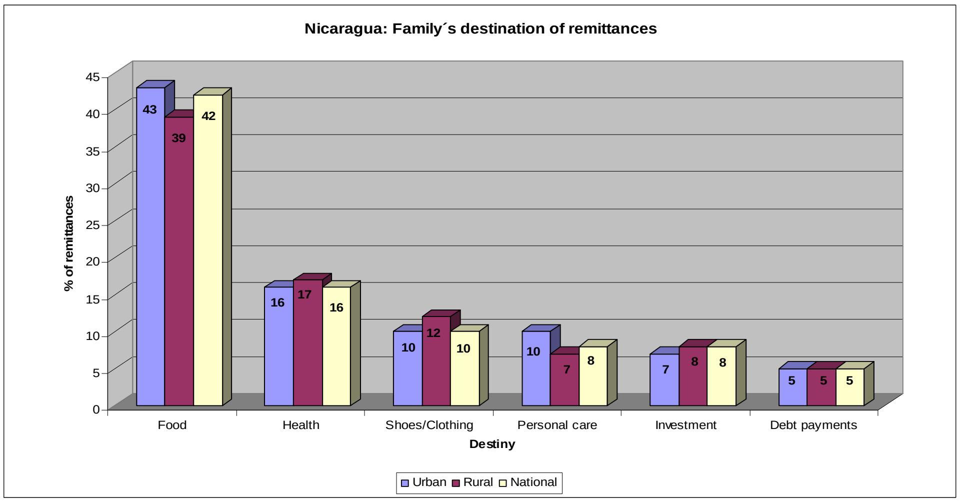
Nicaragua's economy depends on remittances. Exports account for US$ 1,200 million while remittances are around US$ 700 to US$ 800 millions. Temporal migration has been an important exit for rural families. Temporal migration allows families to migrate in harvesting season to Costa Rica and/or El Salvador in order to obtain funds for sowing in May. For these activities, families organize their labor force and funds to take advantages of migration. Alternatives for saving and investment should be promoted by public policies, in order to generate accumulation and savings..



Grigsby and Perez, 2007 based on CEPAL 2006

And SMEs

Remittances are a key driver for consumption at domestic markets and SMEs depend on them. Therefore, some medium-term effects might be expected. Most of remittances are used to buy food, around 40 %, and in a period of crisis, we can expect families will focus their expenses on food and will reduce investment (case of furniture), expenditure on helath, personal care, cloth and shoes (SMEs in internal trade). Consequently, SMEs in services and non-food related business are those that are most vulnerable to shocks in remittances and unemployment.



Grigsby and Perez, 2007 based on CEPAL 2006

Policies Facing Effects of the Global Crisis

Three different paths to face effects of the crisis have been developed. First, National Government applied policies to maintain a healthy macroeconomic environment, cutting 20 % of public expenditures, regulating credit for consumption. At the same time, public policies to ensure food security and product have been launched through productive Credits and transferences funds for Food Security Programs. In order to fund these initiatives, Nicaragua will apply to emergency loans from IMF, WB and BCIE.

Second is the case of private large firms, there is a reduction of production volumes, workers and salaries. Textile sector is the first to be affected, followed by tourism and services (transport, internal trade etc). Third is the case of SMEs. Many have low levels of fix investment and are reallocating their capital on new products or sector, mainly around food markets. However, there are those who face serious limitations to changing economic activities. Even though there is a quite important crisis in Costa Rica, El Salvador and USA, international migration still is an option for short or long term migration.

Development agencies are devoting their efforts in two areas: promoting alternative markets such as organic, fair markets (Coffee, sesame, artisans) or eliminating levels of intermediation. Some scholars do not agree with this type of intervention since they argue is a way to enhance market distortion. However, NGOs believe in the necessity of break down monopolies; therefore, they promote integrating Indigenous communities with small and medium processors in wooden furniture, reducing intermediaries along the value chain. They also propose the creation of bank of inputs in cases of wood, bakering or agricultural products. Using the bank SMEs might benefit from economies of scale and credit alternatives.

The second emphasis is to link SMEs to large firms that are leading each value chain. In the case of milk processors linking them to Parmalat; coffee growers link them to exporters, vegetables producers or intermediaries to Wal-mart. In this case, NGOs provide technical assistance and support quality control. Fulfilling large distribution firm's requirements demand investment and technological change. Small enterprises need a long term investment to achieve it. Finally, it seems that policies to stimulate consumption through credit association /cooperatives (which will offer credit to artisans to buy inputs and credit to consumers to buy products) might be a key policy recommendation during and following the global financial crisis. Both policies will address vulnerability issues in these types of enterprises.

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