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Small Enterprise Employment*

## **Creating a Conducive Policy Environment for Employment Creation in MSEs in Chile**

by  
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through Small Enterprise Development  
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International Labour Office • Geneva

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## Foreword

Policies, institutions and regulations that provide an enabling environment for small enterprises can make a substantial contribution to employment creation. This report is the outcome of a research project undertaken by the International Labour Organization (ILO) to analyse how the regulatory environment affects the growth of micro and small enterprises (MSEs) and, in turn, the generation of MSE employment in the Chilean economy.

This assessment of the policy environment for micro and small enterprises in Chile is based on a careful mapping of existing laws and regulations. Despite a policy and regulatory framework that is relatively transparent and well implemented, micro-enterprises in particular tend to suffer from the costs of compliance. Moreover, indicators of job quality in MSEs show that social security coverage in these enterprises tended to decrease during the 1990s.

The ILO's InFocus Programme on Boosting Employment through Small Enterprise Development (IFP/SEED) initiated an international research project on the policy environment for MSEs and its impact on the volume and quality of employment created by these enterprises. Seven countries participated in this research effort: Chile, Guinea, Pakistan, Peru, South Africa, Tanzania and Viet Nam. This working paper is part of the series on "Conducive Policy Environment for Small Enterprise Employment" by IFP/SEED.

These research activities are leading to new policy training materials and policy guidelines. Through action programmes at country and regional levels, SEED works with national stakeholders to assess the policy environment and to strengthen national and local capacities to design, implement and evaluate policy reform. SEED also maintains a database on national policies, laws and regulations pertaining to small enterprise development, which can be consulted on-line on SEED's website (<http://www.ilo.org/seed>).

The author of this working paper is a sociologist and economist. She is currently a research fellow at the University of Texas at Austin. This research was jointly supported and coordinated by IFP/SEED and the ILO Office in Santiago de Chile.

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## Introduction

This paper examines the policy, legal and institutional framework for micro and small enterprises (MSEs) from 1990 to 2000 in Chile. It evaluates the degree to which the institutional environment<sup>1</sup> enables MSEs to be sources of decent jobs. The focus is on employment in the MSE sector. Economic competitiveness and quality of employment are analysed at the same time, since both elements reinforce each other: a dynamic business will be willing to provide decent jobs, while workers who have good quality jobs will become more productive and increase business profitability.

Two main questions guide this research. What practices have been positive or negative for the development of the MSE sector as an employment generator of decent jobs? What elements give shape to these practices as successful or unsuccessful initiatives? The relationship between the institutional background and the quality and quantity of jobs in MSEs is analysed within the Chilean social, cultural and economic context.

Micro-enterprises are defined as non-agricultural businesses with two to nine workers; small enterprises with 10 to 49 workers; medium and large enterprises with 50 or more workers. Self-employment has been analysed separately since own-account workers are not legally obliged to comply with many of the requirements of the Labour Code, such as labour contracts, health insurance and social security. However, the institutional environment affects self-employment in other ways, mainly in business regulations. The relative position of MSEs in terms of economic dynamism and employment patterns is evaluated using several national surveys. This research is complemented by a special ILO survey comprising 300 MSEs.<sup>2</sup> Annex 1 describes the main sources of data.

This paper is organized in five parts. Part 1 provides a general overview of the Chilean political and economic systems. In Part 2, the MSE sector is described in terms of economic and employment performance. Here the research focuses on the extent to which the identified pattern of employment in MSEs is desirable in terms of socio-economic development. Part 3 assesses the institutional framework and its effects on MSEs. Part 4 highlights those features of well-designed policy and legal environments that lead to employment creation in MSEs, and what is required for effective implementation of policies and laws. Part 5 summarizes the findings and draws conclusions on the bargaining power of social actors in the MSE sector, the lack of institutional coordination and several relevant biases against MSEs in Chile, despite its relatively transparent policy environment.

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<sup>1</sup> The concepts “institutional environment” or “institutional framework” are used as synonyms for policy framework, legal or regulatory framework and institutional framework, taken as a whole. The policy environment is defined as public policies and programmes affecting MSE performance; the regulatory framework as laws regulating the creation and performance of enterprises. The institutional environment refers to those government agencies, private institutions and NGOs related to MSEs.

<sup>2</sup> Espinosa, 2001.

## 1. Macroeconomic overview

This section provides a historical framework of the social and economic processes which model the current entrepreneurial culture and the institutional environment. It also provides a description of the economy and the labour market in Chile during the 1990s.

### A. Historical perspective

The entrepreneurial culture and the institutional environment in Chile during the 1990s were determined by the transition to democracy, the economic reform of the mid-1970s and the macroeconomic policies that reinforced liberalization and privatization. Those factors which influenced the economy and the labour market during the 1990s, such as the political and social changes, economic reform and the labour reform in earlier decades, are reviewed below.

#### 1.1 Political and social changes

Chile was politically organized as a liberal democracy, in which political authorities had been democratically elected until the period of authoritarian government (1973-1989). During this period, the main consequences of the collapse of the democratic regime were the suppression of basic freedoms (of expression and association), the proscription of political parties, trade unions and entrepreneurial corporations, the dissolution of parliament and the *de facto* abolishment of the 1925 Constitution. Thus the policy environment during the 1990s in Chile is characterized by its transition to democracy and the restitution of civil participation through the reinforcement of social dialogue, which had been severely restricted during the period of authoritarian government.

Social dialogue is defined as “periodical negotiations aiming at the establishment of consensus on public policies or decisions affecting the development of the country, particularly, decisions affecting income distribution and opportunities”.<sup>3</sup> During the twentieth century in Chile, social dialogue developed within the institutional framework as *four*-sided bodies composed of trade unions, political parties, entrepreneurs and Government. Trade unions had evolved into strongly organized actors by generating alliances with some political parties that used their voice to mediate between trade unions, the executive power and the legislative power and succeeded in getting a set of social laws passed incorporating workers’ demands. However, the proscription of political parties (mainly those associated with trade unions) suppressed the conduit through which workers channeled their opinions and requests. The trade unions were directly neutralized when the military junta dissolved the *Central Unica de Trabajadores* (CUT). Thus the 1973 coup effectively suspended institutional conditions for the development of social dialogue. It also excluded the actors who had historically promoted social dialogue.

The transition to democracy has been consolidating since the military government was defeated by the *Concertación de Partidos por la Democracia*. In March 1990, the Center-Left Alliance won the presidency. President Patricio Aylwin governed from 1990 to 1994, Eduardo Frei from 1994 to 2000, and Ricardo Lagos is the current President of the Republic. The

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<sup>3</sup> Muñoz, 2000.

priorities of these governments have been the re-establishment of the democratic institutional order, the generation of political and legal conditions to solve the problems of violation of human rights during the military government, the improvement of social conditions and the alleviation of poverty levels.

During the 1990s, basic freedoms and previously abolished institutions were re-established, including social dialogue bodies to generate discussion about the main topics affecting MSEs, for all actors involved in the productive process.<sup>4</sup> The transition allowed different bodies to emerge, which were aimed at putting the “MSME issue” on the agenda through social dialogue. Examples include the “National Agreements”<sup>5</sup> in the beginning of the decade, the “Productive Development Forum”<sup>6</sup> in 1994, and the Public-Private Committee for MSMEs<sup>7</sup> in 1999. Social dialogue bodies during the 1990s tried to incorporate the interests of groups that had been disadvantaged by the previous government. Thus, the main slogan of Chilean governments since 1990 has been “Boosting Economic Growth with Equity”. However, due to the weak participation of MSEs in social dialogue, the programmes and reforms aimed at boosting productivity have gained importance in relation to social policies for reinforcing equity. While government efforts have been mainly directed at boosting productivity, MSEs have lacked the capacity to organize themselves into a proactive sector. This is preventing the Government from reaching the equity goal of their slogan.

## 1.2 Economic reform

Chile was one of the first countries in the Latin American region to adopt economic reforms in 1975. Liberalization broke up many productive clusters, isolating industries and creating a natural division between competitive businesses looking for resources in the international market and powerless businesses lacking resources and/or productive capacity to do so. MSEs concentrated on the non-tradable sector (services, commerce), sharing socio-economic and cultural features, giving shape to their interests and their capacity to bargain. Economic reform also affected the policy-making process. The State was increasingly aiming to optimize the allocation of resources by becoming a second floor actor – i.e. diminishing its direct involvement in productive activities.

The old welfare model has been replaced by a new model where the actors’ capacity to demand privately-provided public facilities has become crucial. The reinforcement of proactivity as a decisive factor within the policy environment affects the relative position of MSEs in the economy and the labour market. Medium and large enterprises have rapidly adapted themselves to these changes, whereas MSEs are on the sidelines of the new model. For example, there is an observable lack of entrepreneurial cohesion among micro and small entrepreneurs. The larger firms have been more successful in creating business associations

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<sup>4</sup> Social dialogue is usually tripartite (workers, employers and government) but MSE workers are weakly organized and representation is limited to employers and the public sector. The relationship between micro enterprise employers and their employees tends to be much closer and more personal than in bigger enterprises. Thus, any conflict is likely to be solved through informal negotiations rather than formal negotiations. However, beyond the conflict-resolution problem, workers’ bargaining power becomes a crucial issue to introduce equity in social dialogue. In other words, it is argued that all actors should have the same opportunities and resources to negotiate; however, as it is demonstrated in this research, workers are in a rather disadvantageous situation regarding this matter.

<sup>5</sup> Acuerdos Tripartitos and the MSME Plan. Afterwards it was transferred to CORFO (see Annex 2).

<sup>6</sup> Foro de Desarrollo Productivo. It was dissolved in 1999.

<sup>7</sup> Comité Público Privado para la Pequeña Empresa. See policy mapping in Part 3 of this report.

that reinforce their capacity to demand the public facilities now provided by the private sector. As a result, MSEs seldom participate in social dialogue bodies.

The military government gave strong priority to the implementation of structural reforms in order to diminish public intervention in the productive area and to build a strong private sector. On their more visible side, the reforms were aimed at diminishing the size of the State. The new economic model replaced the old import substitution model and established free-market principles. During the 1970s and the 1980s, most State enterprises were privatized, whereas in the arena of the provision of public goods, the State introduced “quasi-markets”<sup>8</sup> (private organizations providing public facilities under government supervision and subsidy) in education, health and social security. At the same time, the reform sought to diminish the size of the state bureaucracy and to eliminate the fiscal deficit. Therefore, the public budget diminished from 20 per cent of GDP in 1972 to 12 per cent in 1981, which produced a reduction of social expenditure and public investment. Public employment shrunk 30 per cent during the same period.<sup>9</sup> One of the decisive features of the economic reform was the opening of markets to the international economy. The main objective was to develop a strong export sector focused on the country’s comparative advantages. The financial market was opened as well, and the private sector was placed as the main external debtor.<sup>10</sup>

In the previous economic model, the manufacturing and mining sectors were the engines of economic development. This contributed to the development of trade unions of wage workers as the main actors in social dialogue.<sup>11</sup> When these sectors lost their leading role to the emerging export sector, workers also lost their bargaining power. This is how the new economic model reoriented social dialogue.

This new scenario lessened the possibilities for development of trade unions, which were once socially and politically dynamic. The decrease in the number of businesses with more than 1,000 employees also contributed to the deterioration of trade unions.<sup>12</sup> This change explains the fragmentation of both the productive structure and social dialogue. Another aspect that explains the fragmentation of social dialogue is the shift of collective bargaining toward trade unions organized within individual enterprises rather than by economic sector, as the following section shows.

### **1.3 Labour reform**

Labour laws were modified in 1979 in order to generate the conditions for a successful economic transition. The objective of the Labour Plan was to generate flexibility in the labour market, to diminish labour costs and collective bargaining by deregulating and adapting the labour market to the new economy. Labour reform affected individual and collective labour relationships. Regarding the former, the reform modified the terms of labour contracts, such as working conditions, contract duration, sub-contracting permission and dismissal reasons, which included “non-justified” dismissal.<sup>13</sup> Regarding collective labour, the reform situated the bargaining process at a business level. The conditions for creating trade unions were

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<sup>8</sup> LeGrand, 1993.

<sup>9</sup> Larrain, 1991 in Meller, 1996.

<sup>10</sup> Meller, 1996.

<sup>11</sup> Ruiz-Tagle, 1985; Campero, 2000.

<sup>12</sup> Campero, 2000.

<sup>13</sup> Tokman, Martínez, 1999; Urmeneta, 1999.

restricted in terms of time and number of members. The reform also introduced the possibility of non-regulated bargaining<sup>14</sup> in which one or more employers can negotiate with a group of employees. This diminishes the trade union's importance as a bargaining device: it has been argued that the negotiating power is directly related to the level of organization of the interested party. Unorganized employees would be less likely to succeed than trade unions.<sup>15</sup> Although the reform did not proscribe the creation of federations (groups of trade unions), it banned their possibility to negotiate. Federations were restricted to the provision of education and technical assistance. Issues to be negotiated were also limited. The right to strike was weakened by the reform: now, workers on strike could be individually reincorporated and replaced.

The Labour Plan hampered social dialogue due to the dictatorial character of the reforms,<sup>16</sup> reshaped the old protective code and suppressed the paternalistic role of the Labour Code.<sup>17</sup> Subcontracting possibilities opened a new set of choices to use workers who were not adequately protected by law. Similarly, subcontracted workers were too scattered to build an organized group and to contribute to social dialogue.

Nor did the new possibility of establishing fixed-term contracts contribute to the strong organization of workers or to social dialogue. On the contrary, it generated uncertainty and job instability,<sup>18</sup> reinforced by "non-justified" dismissals. Moreover, atomization and the fragmentation of the productive structure and limited-duration contracts also prevented the formation of groups with common demands.

The autonomy of trade unions was severely reduced<sup>19</sup> and the Labour Code limited the actors, issues and content of bargaining.<sup>20</sup> And, while the regulatory role of the State noticeably increased in the area of collective relationships, in practice, the role of the State was replaced by the market in terms of labour relationships and conflict resolution.<sup>21</sup> The State abandoned the mediating role in this area and limited itself to supervising the fulfilment of rules.<sup>22</sup> With this, the State lost its capacity to generate social dialogue.

The Labour Code was reformed again in 1990, in order to generate more stability and certainty among workers and to preserve the flexibility required by the new economic model. This reform prohibited "non-justified" dismissal although not for all categories of workers. It also re-established "economic necessities of the enterprise" as a reason for dismissal and suppressed the maximum duration of strikes. However, the main issues affecting the bargaining power of trade unions (negotiation among employers and according to sector of activity) were not approved. A second labour law reform was passed in 2001. With this reform, the Government wanted to boost the bargaining power of trade unions by eliminating the possibility of hiring employees during strikes and allowing inter-enterprise negotiations. It is too soon to evaluate the impact of this reform on the weakly represented MSE sector.

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<sup>14</sup> OIT, 1994. OIT, 1994.

<sup>15</sup> Dunleavy, 1994.

<sup>16</sup> Ruiz-Tagle, 1985; Tapia, 1992; OIT, 1994; Campero, 2000.

<sup>17</sup> OIT, 1994, Urmeneta, 1999.

<sup>18</sup> Urmeneta, 1999.

<sup>19</sup> Ruiz-Tagle, 1985; OIT, 1994; Urmeneta, 1999.

<sup>20</sup> OIT, 1994.

<sup>21</sup> *idem*.

<sup>22</sup> OIT, 1994; Ruiz-Tagle, 1985.

## **B. Economic structure, economic performance and the labour market**

During the 1990s, the Chilean economy experienced a rather positive performance until the crisis in 1998. The economic authorities were committed to a sound macroeconomic environment boosting foreign trade and the domestic production of competitive goods. The old protectionist model of import substitution had been replaced during the 1970s by a free-market model. The 1990s were increasingly oriented to diminishing the barriers to the development of foreign trade, which was affecting the internal market and domestic production of non-competitive goods.

Table 1.1 shows this evolution of macroeconomic conditions in the 1990s, which can be divided into two periods: growth from 1990 to 1998 and crisis from 1998 to 2001. The growth period is characterized by the decreasing inflation rate, an appreciating exchange rate and a steady interest rate.

In 1992, the Central Bank became an independent institution, in an attempt to prevent inflationary pressures and keep prices stable. As a result, inflation decreased dramatically. The current exchange policy allows the exchange rate to move freely within a range that allows the authorities to manipulate the interest rate when the economy needs to be either reactivated or slowed down, without endangering the inflation target.

While the Chilean economy can be defined as a liberal system, there are legal provisions in the financial market to prevent external capital outflows. This has been convenient for those sectors that can access external capitals. Tariffs and barriers to external commerce have been slowly released: although Chile is not a member of MERCOSUR yet, other agreements such as the NAFTA have encouraged authorities noticeably to diminish tariffs.

**Table 1.1. Macroeconomic indicators, 1990–2001**

Year	Real exchange rate	GDP <sup>a</sup>	Consumer price index <sup>a</sup>	Real interest rate <sup>b</sup>
1990	n.a.	3.7	26.0	n.a.
1991	-5.6	8.0	21.8	8.5
1992	-8.2	12.3	15.4	8.1
1993	-0.7	7.0	12.7	9.2
1994	-2.7	5.7	11.4	9.3
1995	-5.7	10.6	8.2	8.5
1996	-4.8	7.4	7.4	9.3
1997	-7.7	7.4	6.1	8.8
1998	-0.2	3.9	5.1	11.9
1999	5.5	-1.1	3.3	8.2
2000	4.5	5.4	3.8	7.5
2001	11.5	2.8	3.6	n.a.

Note: <sup>a</sup> Annual rate of variation (%); <sup>b</sup> Long-term real interest rate (%).

Source: Central Bank, INE.

Until 1997, in the absence of depreciation pressures, the interest rate remained at around 8 per cent and GDP growth rate at around a satisfactory 7 per cent on average. With the financial crisis in 1998, the interest rate jumped to 11 per cent, with major consequences

for the economy. GDP showed a negative variation rate (-1.1 per cent in 1999) for the first time in the decade. As Table 1.2 shows, the economic recession triggered an increase in the unemployment rate from 6.1 per cent in 1998 to 9.7 per cent in 1999.

**Table 1.2. Unemployment rate, 1990-2001**

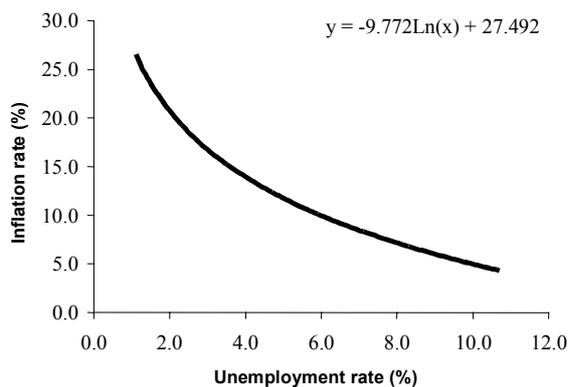
Year	Unemployment rate <sup>a</sup>
1990	7.8
1991	8.2
1992	6.7
1993	6.5
1994	7.8
1995	7.4
1996	6.5
1997	6.1
1998	6.1
1999	9.7
2000	9.2
2001	9.1

Note: <sup>a</sup> Annual average (%).

Source: National Statistical Institute (INE).

In the context of a liberal economy, it is worth analysing the effects of macroeconomic policy on unemployment. The cost of keeping inflation at a very low level appears to be an increase in the unemployment rate. Using monthly data for the period 1992-2000, the relationship is as follows: for each percentage point the inflation rate decreases, the unemployment rate increases by almost 10 per cent, as Figure 1.1 shows.

**Figure 1.1. Relationship between inflation and unemployment rates (Phillips curve), 1992-2000**



Source: Author's calculations based on data from the Central Bank of Chile and the National Statistical Institute (INE).

Since the macroeconomic policy has been committed to low inflation, the economic crisis in 1998 had a multiplier effect on the costs related to keeping the inflation rate at a target level. The interest rate had to be abruptly increased and negatively affected the highly indebted sectors. Chile is a country with a well-developed financial sector. Until the recession, MSEs had had considerable access to credit from the private sector, although at high (and variable) interest rates. When the crisis occurred, indebted MSEs faced a prohibitive increase in the interest rate, which often made debt payments impossible. Many MSEs went bankrupt, causing considerable job loss. Other enterprises were forced to economize by stopping social security payments to workers and generally diminishing the quality and safety of jobs.

Since 1999, the Government and the economic authorities have been committed to restoring economic activity by diminishing interest rates and establishing debt renegotiation programmes (in 2000). Although the GDP has rapidly recovered, unemployment rates are still high and not all sectors are participating in the economic recovery. MSEs require much more support than the programmes that have been implemented, in order to survive the crisis. Nonetheless, the depreciation of the Chilean peso from 1999 to 2001 has had positive effects on exports, which have noticeably increased over imports. However, as Part 2 shows, the export sector is highly concentrated on larger enterprises, although some smaller businesses have successfully competed with the more expensive imported goods.

## 2. MSEs in employment and the economy

In order to determine the extent to which the pattern of MSE employment is desirable in terms of socio-economic development, this section first evaluates the quantity and quality of employment in MSEs during the 1990s and then portrays the economic situation of enterprises with low levels of turnover.

### A. *Employment patterns in MSEs and MLEs*<sup>23</sup>

There is no direct evidence on the evolution of employment shares by enterprise size class during the abrupt market reforms of the 1970s and 1980s. However, the number of self-employed workers and small enterprises increased, while at the same time economic wealth concentrated in conglomerates of large enterprises. According to national labour force surveys, there were 55 employees per employer in the Chilean labour market in 1970. By 1986, this figure had dropped to 20.<sup>24</sup>

According to data on the composition of non-agricultural employment by enterprise size class from the CASEN survey 2000, 64.4 per cent of non-agricultural employment was accounted for by micro and small enterprises: 44.7 per cent in micro-enterprises with 1 to 9 workers and 17.7 per cent in small enterprises with 10 to 49 workers. Unfortunately, the CASEN survey does not allow the construction of a consistent series on the share of different enterprise size classes over time, given that the questionnaire experienced a slight change between 1996 and 1998.

However, it is possible to measure the share of micro-enterprises in total non-agricultural employment over time based on the Labour Force Survey of the National Statistical Institute (INE). According to this source, between 1992 and 2002, the share of micro-enterprises in non-agricultural employment decreased slightly, from 46.7 to 45.3 per cent, as Table 2.1 shows.

**Table 2.1. Non-agricultural employment according to enterprise size (percentage of total non-agricultural employment)**

Enterprise size (number of workers)	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
1 to 4	40.2	39.5	40.6	39.6	37.8	38.2	40.0	40.8	39.8	40.3	40.3
5 to 9	6.5	5.6	6.1	5.7	5.2	5.4	5.6	5.5	5.1	5.0	5.0
10 and more	53.3	54.9	53.2	54.6	57.0	56.4	54.5	53.7	55.1	54.6	54.7
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

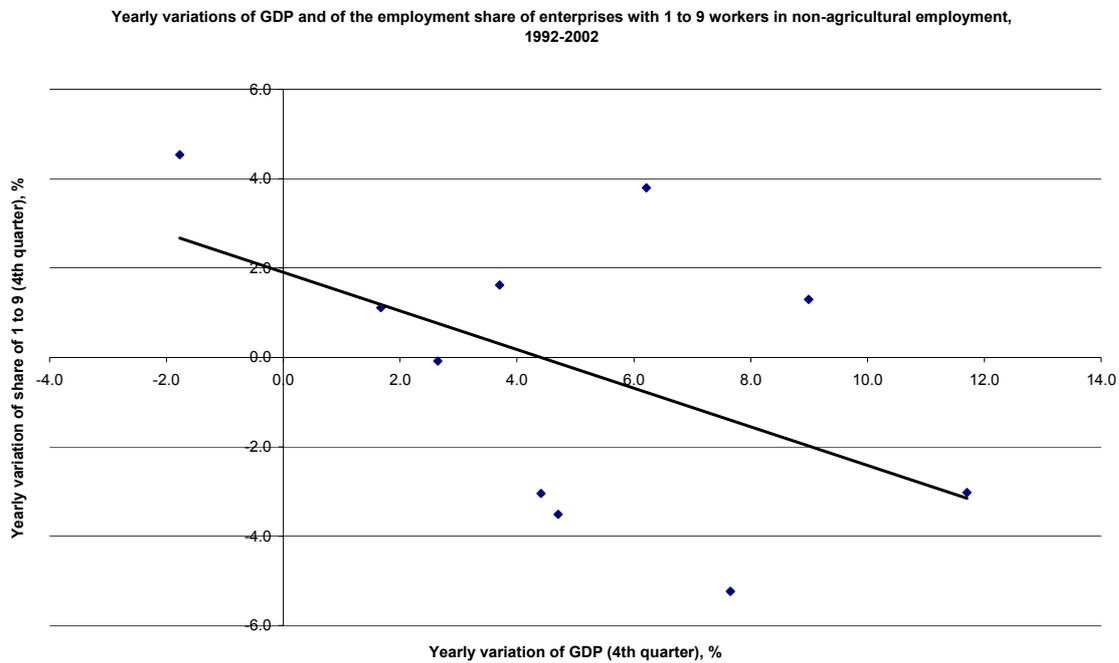
Source: ILO based on data from the National Statistical Institute (Encuesta Nacional del Empleo, October-December of each year).

<sup>23</sup> This section was updated and edited by the ILO Office in Santiago.

<sup>24</sup> Reinecke, 2000, Table 3.10.

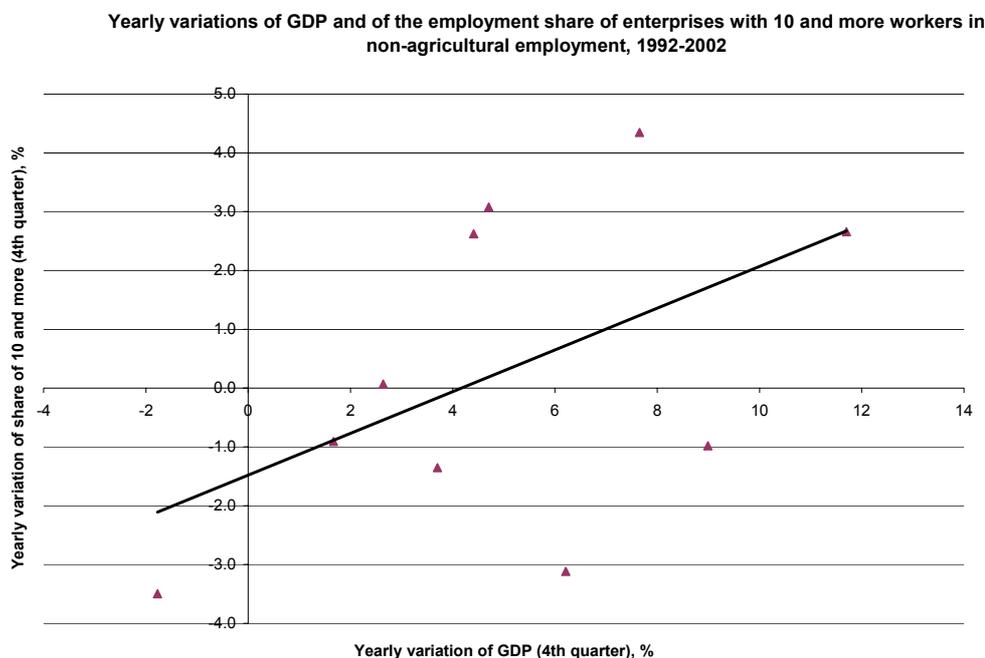
During the period of fast economic growth, up to 1997, micro-enterprises tended to decrease their employment share while the recession in 1998/99 led to an increase in their employment share. However, many MSEs which survived the crisis still struggle with the financial consequences that are hampering their sustainability and employment creation potential. Over the 1992-2002 period, statistically the share of enterprises with 1 to 9 workers in non-agricultural employment tended to decrease in years of fast economic growth but increased when economic growth was slow or negative, suggesting a “buffer” function within the labour market, as Figure 2.1a shows. Conversely, the share of small, medium and large enterprises increased in years of fast economic growth, as Figure 2.1b shows.

**Figure 2.1a. Correlation between GDP variation and employment share of micro-enterprises**



Source: ILO based on data from the National Statistical Institute (INE) and the Central Bank of Chile.

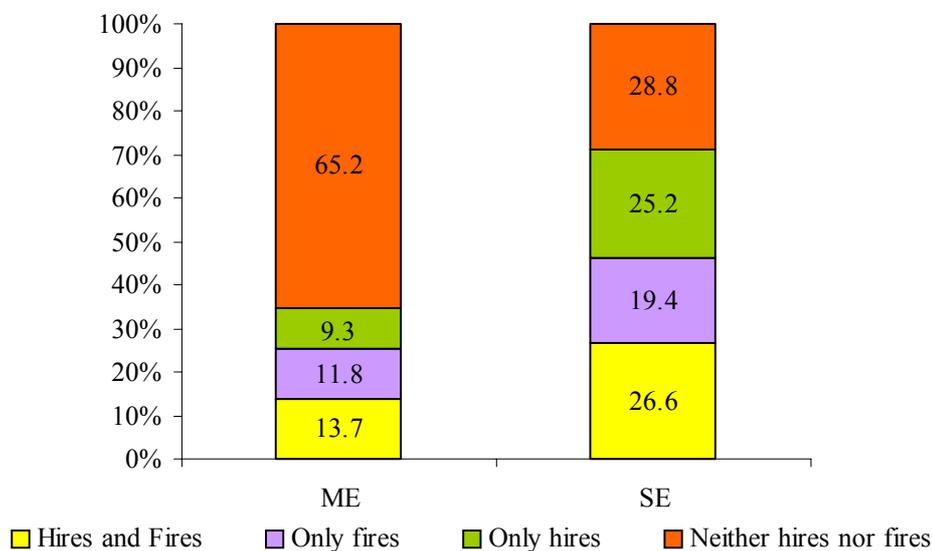
**Figure 2.1b. Correlation between GDP variation and employment share of enterprises with 10 and more workers**



Source: ILO based on data from the National Statistical Institute (INE) and the Central Bank of Chile.

Evidence from the ILO MSE Survey (see Annex 1) demonstrates that businesses that have survived the crisis have not undertaken radical employment reduction strategies in order to cope with the recession. Figure 2.2 shows that many firms – 65.2 per cent of surviving micro-enterprises and 28.8 per cent of small enterprises – neither hired nor fired employees but instead restructured employment by diminishing working hours, for instance. The evidence of the MSE Survey demonstrates that during the crisis permanent full-time jobs in MSEs diminished by 6.4 per cent, whereas permanent part-time jobs increased by 41.3 per cent. Thus, MSEs dealt with the economic crisis by reducing the number of hours worked – directly affecting quality of jobs – rather than through employment contraction.

**Figure 2.2. Employment strategies in MSEs during the economic crisis (1999-2001)**



Source: ILO MSE Survey 2001.

### Gender gap

Women workers are less represented in large enterprises, where the number of men workers is almost double that of women, while women’s share among the self-employed and micro-enterprises is higher.

It is commonly understood that less qualified workers are relatively more concentrated in micro-enterprises. According to conventional understanding, workers who cannot fulfill job requirements in the medium and large enterprises apply to MSEs as a “last resort”. An alternative hypothesis suggests that the process of globalization and new management styles are boosting the creation of MSEs because horizontal organizational structures and the personalization of services are easier to implement in smaller firms. According to this theory, smaller firms would attract qualified workers in order to implement managerial devices boosting competitiveness in the new economy. However, the indicators selected below (Tables 2.2, 2.3 and 2.4) show that, although MSE workers are more qualified than in the past, considerable differences in education exist between MSE and medium and large employees.

**Table 2.2. Average years of education of workers according to enterprise size, 1990-2000**

		Self - employment <sup>a</sup>	Micro <sup>b</sup>	Small <sup>c</sup>	ML <sup>d</sup>	Total
Years of education (average)	1990	8.6	10.3	11.5	11.6	10.4
	2000	9.4	10.8	11.9	12.5	11.2
Gender gap (male average/ female average)	1990	1.06	0.83	0.83	0.86	0.95
	2000	1.06	0.86	0.86	0.91	0.97

Notes: <sup>a</sup> Self-employment and one-person businesses; <sup>b</sup> Non-agricultural workers in enterprises with 2 to 9 employees; <sup>c</sup> Non-agricultural workers in enterprises with 10 to 49 employees; <sup>d</sup> Non-agricultural workers in enterprises with more than 50 employees. ML = medium and large enterprises.

Source: CASEN Survey, 1990-1998.

According to Table 2.2, workers with more years of education tend to be employed in medium and large enterprises. Although this situation has improved in recent years (workers in micro-enterprises have, on average, 0.5 years of education more than ten years ago) workers in medium and large enterprises show a higher improvement (0.9 years). Women workers tend to be more educated than men workers. The difference diminishes with the size of the business, i.e. the smaller the business the more sex homogeneity in terms of education. This trend has remained roughly stable during the 1990s. In 2000, 40.4 per cent of workers in micro-enterprises and 31 per cent of workers in small enterprises had had less than secondary education compared with 25.1 per cent of employees in medium and large enterprises, as Table 2.3 shows. In contrast, 37.5 per cent of workers in medium and large enterprises had higher education compared with 32.5 per cent of small enterprises workers and 20.2 per cent of micro-enterprises workers.

**Table 2.3. Level of education of workers according to enterprise size, 1998**

	Self- employment <sup>a</sup>	Micro <sup>b</sup>	Small <sup>c</sup>	ML <sup>d</sup>	Total
Workers (% of total employment in each category)					
Less than secondary education	54.6	40.4	31.0	25.1	37.0
Secondary education	25.7	34.3	33.8	35.0	39.0
More than secondary education	11.8	20.2	32.5	37.5	25.1

Notes: <sup>a</sup> Self-employment and one-person businesses; <sup>b</sup> Non-agricultural workers in enterprises with 2 to 9 employees; <sup>c</sup> Non-agricultural workers in enterprises with 10 to 49 employees; <sup>d</sup> Non-agricultural workers in enterprises with more than 50 employees. ML = medium and large enterprises.

Source: CASEN Survey, 1998.

The distribution of workers according to their level of education corresponds with the age structure of workers in each type of enterprise. Evidence demonstrates that the smaller the business the younger workers it has, as Table 2.4 shows. For example, in 1990, 17.4 per cent of workers belonged to the 15 to 24-year-old group (workers in education age). This group is more highly represented in micro-enterprises (24.1 per cent of workers) than in medium and

large enterprises (16.4 per cent). However, the fact that education is becoming more widespread has changed these shares in all types of enterprise. Thus, while 12.1 per cent of total employees were in education age in 2000, 15.5 per cent of workers in micro-enterprises and 13.6 per cent in small enterprises were in education age. This could indicate that young people in Chile are exploring new and more flexible forms of employment according to the new management styles.

**Table 2.4. Age structure of workers according to enterprise size, 1990-2000**

	Self-employment <sup>a</sup>	Micro <sup>b</sup>	Small <sup>c</sup>	ML <sup>d</sup>
Workers under 24 years old (% of total employment in each type of firm)				
1990	13.4	24.1	18.5	16.4
2000	7.4	15.5	13.6	12.0

Notes: a Self-employment and one-person businesses; b Non-agricultural workers in enterprises with 2 to 9 employees; c Non-agricultural workers in enterprises with 10 to 49 employees; d Non-agricultural workers in enterprises with more than 50 employees. ML = medium and large enterprises. Source: CASEN Survey, years 1990-2000.

Table 2.5 shows that micro-enterprises tend to concentrate relatively more workers who belong to poor households: in 1990, 29 per cent of self-employed workers and 27.7 per cent of micro-enterprise workers were at the poverty level, compared to 23.7 per cent of the total. Poverty levels in small enterprises were slightly below poverty levels in total employment, in 1990. This situation steadily improved during the decade for all workers regardless of enterprise size, until 2000, when the trend reversed. More workers were under the poverty line and most of this increase was concentrated in self-employment and micro-enterprise workers.

**Table 2.5. Workers below the poverty line according to enterprise size, 1990-2000**

	Self-employment <sup>a</sup>	Micro <sup>b</sup>	Small <sup>c</sup>	ML <sup>d</sup>	Total
Workers below the poverty line (% of total employment in each type of firm)					
1990	29.0	27.7	22.9	20.6	25.3
1998	11.3	13.3	10.9	7.5	10.3
2000	12.1	14.1	9.9	7.8	10.7

Notes: <sup>a</sup> Self-employment and one-person businesses; <sup>b</sup> Non-agricultural workers in enterprises with 2 to 9 employees; <sup>c</sup> Non-agricultural workers in enterprises with 10 to 49 employees; <sup>d</sup> Non-agricultural workers in enterprises with more than 50 employees. ML = medium and large enterprises.

Source: CASEN Survey, 1990, 1998, 2000.

Table 2.6 shows that in 1990 a micro-enterprise worker earned on average 72.5 per cent of a medium or large enterprise worker. In 1998, this figure increased to 86.1 per cent. In small industries the situation was similar. According to the ENIA survey,<sup>25</sup> salaries in small enterprises represented roughly 50 per cent of those in large enterprises. The gender gap in salaries is also considerable. Although a general feature in all types of enterprise (in 1998, men's incomes were 52 per cent higher than women's), the inequalities tended to be more noticeable in micro businesses. Table 2.6 shows that the percentage of micro-enterprise workers earning less than a minimum wage was 14.7 per cent, or almost 5 times the percentage in medium and large enterprises. The share of workers earning less than a minimum wage diminished in 1998 but rose again in the way of the 2000 economic crisis in all types of enterprise.

**Table 2.6. Workers' earnings according to enterprise size, 1990-2000**

	Self-employment <sup>a</sup>	Micro <sup>b</sup>	Small <sup>c</sup>	ML <sup>d</sup>	Total
Average income (index, average ML=100)					
1990	78.5	72.5	80.8	100.0	83.1
1998	83.5	89.3	90.5	100.0	90.7
Gender gap (male average/female average)					
1990	1.93	1.85	1.40	1.43	1.65
1998	2.02	1.55	1.28	1.33	1.52
Workers earning less than 1 minimum wage (% of total employment in each type of firm)					
1990	19.7	14.7	4.3	3.1	10.7
1998	15.9	11.2	3.9	2.8	8.1
2000	21.1	12.8	5.6	4.3	10.6

Notes: <sup>a</sup> Self-employment and one-person businesses; <sup>b</sup> Non-agricultural workers in enterprises with 2 to 9 employees; <sup>c</sup> Non-agricultural workers in enterprises with 10 to 49 employees; <sup>d</sup> Non-agricultural workers in enterprises with more than 50 employees. ML = medium and large enterprises.

Source: CASEN Survey, 1990, 1998, 2000.

Selected indicators of job quality are shown in Table 2.7. Except for number of hours worked per week, all indicators demonstrate that the micro sector is disadvantaged in comparison with medium and large enterprises.

### Hours worked

In Chile, workers in all types of enterprise work a relatively high number of hours. There are no significant differences by enterprise size.

<sup>25</sup> Annual national industrial survey.

### **Signed work contracts**

Workers in micro-enterprises tend to be less protected than workers in medium and large enterprises in terms of signed work contracts – which is a proof of compliance with regulations on the employer's part and, therefore, of worker protection. There is social and health insurance and access to training programmes. The share of workers with signed contracts has diminished over time. In 1990, 85 per cent of salaried employees had a signed contract compared with 77.7 per cent in 2000. In 1990, 76.4 per cent of micro-enterprise workers had a signed contract compared with 61.2 per cent in 2000. In small enterprises, this percentage diminished from 89.1 to 83.2 per cent and in medium and large enterprises, from 94.1 per cent in 1990 to 90.9 per cent in 2000.

### **Health benefits and social security coverage**

Social security coverage has also diminished over time, especially for self-employed workers. Health insurance provision is the only indicator showing a continuous improvement over the whole decade. However, evidence suggests that private health insurance is directly related to the economic cycle. During the growth period, employment with private health insurance increased in all categories, whereas during the crisis period, it diminished from 31.4 per cent in 1998 to 27.1 per cent in 2000. Public health insurance absorbed the reduction in private health insurance in the last survey period. Public health tended to be increasingly concentrated in micro-enterprises, whereas workers in medium and large enterprises could afford private health insurance.

**Table 2.7. Quality of employment, selected indicators, 1990-2000**

	Self - employment <sup>a</sup>	Micro <sup>b</sup>	Small <sup>c</sup>	ML <sup>d</sup>	Total
Hours worked (average, per week)					
1990	48.5	50.8	48.3	49.0	49.1
2000	51.0	50.5	50.5	50.6	51.1
Workers with a signed contract (% of salaried employment in each category)					
1990	...	76.4	89.1	94.1	85.0
1998	...	62.5	83.9	91.3	77.9
2000	...	61.2	83.2	90.9	77.7
Workers with social security (% of total employment in each category)					
1998	28.4	59.0	84.7	91.0	66.6
2000	24.9	58.3	82.3	90.4	65.5
Workers with private health insurance (% of total employment in each category)					
1990	6.2	15.1	29.5	40.2	22.0
1998	10.4	20.8	36.9	52.7	31.4
2000	8.1	18.0	33.6	46.2	27.1
Workers with public health insurance (% of total employment in each category)					
1990	66.1	65.5	59.3	50.8	59.7
1998	63.7	60.4	54.0	39.8	52.4
2000	67.4	65.8	58.4	47.6	58.2
Workers accessing training programmes in the last year (% of total employment in each category)					
1996	5.6	9.9	18.8	26.1	14.6
1998	7.8	11.9	22.1	38.2	21.8
2000	4.2	8.0	17.2	30.4	16.4

Notes: <sup>a</sup> Self-employment and one-person businesses; <sup>b</sup> Non-agricultural workers in enterprises with 2 to 9 employees; <sup>c</sup> Non-agricultural workers in enterprises with 10 to 49 employees; <sup>d</sup> Non-agricultural workers in enterprises with more than 50 employees. ML = medium and large enterprises.

Source: CASEN Survey 1990, 1996, 1998, 2000.

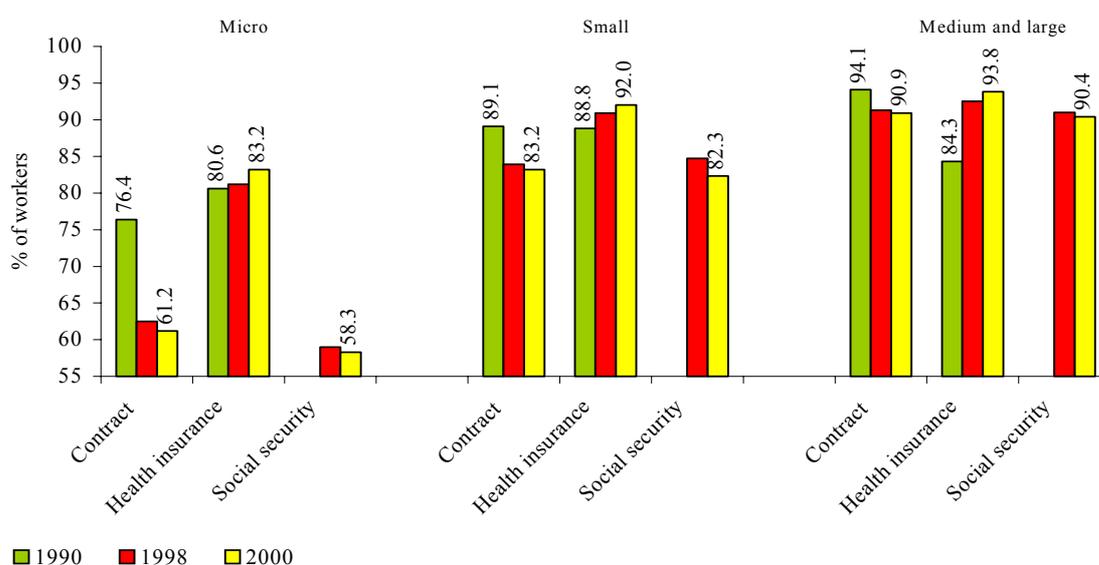
### Non-compulsory benefits

Workers in micro-enterprises tended to use training facilities less than workers in small enterprises and those in medium and large enterprises. Before the SENCE reform (1996), 9.9 per cent of workers in micro, 18.8 per cent in small and 26.1 per cent in medium and large enterprises accessed training programmes. After the 1998 economic reform, these percentages increased to 11.9, 22.1 and 38.2 per cent respectively. Although the reform aimed to improve MSE training access, the main beneficiaries have been medium and large enterprise workers. Significantly, these figures demonstrate that MSEs are failing to access the private organizations that are providing public facilities under government supervision and subsidy. The crisis reversed the increase in training programmes. The training figures for MSEs in 2000 are even below the levels prior to the reform, except for workers in medium and large enterprises.

The indicators of job quality may be classified into compulsory and voluntary benefits. Figure 2.3 shows that compulsory benefits such as signed contracts and social security have been sparser in micro than in small enterprises and also in the medium and large sectors and overall have diminished over time for workers in all types of enterprise. Health insurance is more equitable and is the only compulsory benefit that has increased during the decade. Voluntary benefits such as training have increased due to the reform in the National Training Service. However, training facilities are largely concentrated on workers in medium and large enterprises.

Further evidence from the MSE Survey demonstrates that 42.2 per cent of micro and 59.7 per cent of small enterprises have improved their safety conditions between 1999 and 2001. A total of 46.6 and 54 per cent respectively have given incentives to productivity, whereas 38.5 and 51.1 per cent respectively have increased salaries.

**Figure 2.3. Quality of employment: Compulsory benefits according to enterprise size, 1990-2000**



Notes: Figures correspond to % of workers in total employment in each category. Signed contract refers to workers as % of salaried workers in each category.

Source: CASEN Survey, years 1990, 1998, 2000.

## Social dialogue

One focus of this research is the participation of the MSE sector in social dialogue. Although it is true that in smaller businesses informal mechanisms are more effective for conflict resolution than they are in larger firms, it is necessary for all parties to be equally represented for effective social dialogue. In Chile, as in most other countries, unionization in MSEs is low. The Labour Code includes articles that inhibit the creation of trade unions in very small businesses. In 2000, the great majority of trade unions (68.4 per cent) were in medium and large businesses. Only 4.2 per cent of micro and 9.7 per cent of small enterprise workers have created trade unions compared with 42.8 per cent of workers in medium and

large enterprises. Similarly, only 7.5 per cent of micro-entrepreneurs and 12.9 per cent of small enterprise managers and owners belong to a business association, according to the ILO MSE Survey.

### **B. *Micro and small enterprises: Economic dynamism***

According to data from the Internal Revenue Service (SII) and the analysis of national businesses that pay taxes in the First Category,<sup>26</sup> this paper argues that the smaller the enterprise, the more expensive registration becomes. Wormald and Rozas (1996) have demonstrated that 77 per cent of a representative sample of micro-enterprises in the industrial sector are registered with the SII and 72 per cent actually pay First Category taxes. However, more invisible sectors, such as commerce, are also more likely to remain unregistered. All in all, SII data are sufficiently representative to draw conclusions.

Table 2.8 shows that firms with an annual turnover under US\$60,000 (MEs) represent more than 80 per cent of national enterprises; those with a turnover between US\$60,000 and US\$620,000 per year (small enterprises) comprise around 15 per cent of all businesses, and only 3 per cent of total businesses generate a large turnover.

The growth period was positive for turnover increase: between 1994 and 1997, while the number of businesses increased by 3.7 per cent, the number of large-scale enterprises grew 7.3 per cent a year. Medium enterprises also increased by 4.6 per cent a year. The trend reversed during the crisis in 1998 and 1999: while the number of businesses increased by 3 per cent a year, micro-enterprises showed an increase of 4 per cent a year between 1997 and 1999, whereas small enterprises diminished 0.4 per cent and medium and large enterprises 6.2 per cent a year. Thus, it is likely that both the small and medium/large categories had reduced sales during the crisis and moved into a lower size class.

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<sup>26</sup> Note that the definition used in this database differs from the one considered in this paper in that the *size* of the enterprise is defined in relation to *annual turnover* rather than to employment. These micro enterprises correspond to firms with a turnover over 1 UF and under 2,400 UF per year. Small enterprises have a turnover between 2,401- 25,000 UF and medium and large enterprises above 25,000 UF per year respectively. Note: 1UF = US\$25 approximately. For a definition on this special category of tax payment (First Category), see Policy mapping in Part 3.

**Table 2.8. Number of enterprises and turnover, 1994-1999**

	Micro <sup>a</sup>	Small <sup>b</sup>	ML <sup>c</sup>	Total
1994				
Number of firms	404,599	71,984	13,703	490,286
Percentage	82.5	14.7	2.8	100.0
1997				
Number of firms	432,341	78,805	15,784	15,784
Percentage	82.0	15.0	3.0	3.0
1999 <sup>d</sup>				
Number of firms	467,176	78,122	13,873	13,873
Percentage	83.5	14.0	2.5	2.5
Annual variation (%)				
Number of firms				
1994-1997	3.4	4.6	7.3	3.7
1997-1999	4.0	-0.4	-6.2	3.0

Notes: <sup>a</sup> Turnover between 1 and 2,400UF per year (UF1<sup>27</sup> = US\$25 approximately); <sup>b</sup> turnover between 2,401 and 25,000UF per year; <sup>c</sup> turnover higher than 25,000UF per year; <sup>d</sup> preliminary data.

Source: Internal revenue service (SII).

As Table 2.9 shows, MSEs are predominantly represented in the non-tradable sectors (commerce and services), with medium and large enterprises relatively more represented in the industry sector.

**Table 2.9. Economic sector and business turnover, 1999**

Economic activity (% of firms)	Micro <sup>a</sup>	Small <sup>b</sup>	ML <sup>c</sup>	Total
Agriculture	12.9	11.6	6.9	12.6
Non-agriculture	87.1	88.4	93.1	87.4
Industry	6.2	10.4	16.7	7.1
Commerce	44.8	37.2	38.1	43.6
Services	21.2	22.5	19.9	21.4
Total	100.0	100.0	100.0	100.0

Notes: <sup>a</sup> Turnover between 1 and 2,400UF per year (UF1 = US\$25 approximately); <sup>b</sup> turnover between 2,401 and 25,000UF per year; <sup>c</sup> turnover higher than 25,000UF per year; <sup>d</sup> preliminary data.

Source: Internal revenue services database, 1999.

<sup>27</sup> UF = "Unidad de Fomento" is a value for pesos which changes (almost always upward) on a daily basis to account for a calendar month's inflation. The UF on May 14, 2003 was 17,000.32 pesos in the Central Bank for \$/UF exchange. On the ninth of each month, the Central Bank publishes values for each day until the ninth of the next month.

Business competitiveness is directly related to the variables which help us evaluate the comparative situation of small-scale versus large-scale enterprises (for example, the higher the productivity, the higher an enterprise's competitiveness. In terms of capital, medium and large enterprises own more physical capital per worker and can afford larger investments and technological innovations than MSEs. According to industrial data, labour productivity in small industries is around 42 per cent of that in medium and large enterprises, according to the ENIA/INE 1994 survey. Table 2.10 shows variations in labour productivity in different industries. It is interesting to note that between 1995 and 1997 labour productivity had increased relatively more in small businesses; this also occurred in the domestic private group of businesses.

Since productivity relies on the management of capital and labour inputs, business owners and/or managers must have the ability to plan, operate and control the productive process and enterprise management. Isolation, a lack of information and experience, as well as a lack of negotiating power constitute an important setback for MSEs. This tends to reduce the price of products and to diminished turnover and income. Thus, small industries had a large space in which to develop in terms of bargaining power and labour productivity. With very inexpensive improvements, labour produced more in terms of turnover. This highlights the importance of availability of training and promotion programmes for MSE workers and owners.

**Table 2.10. Labour productivity growth in the manufacturing sector, 1995-1997 (annual variation %)**

Industry	Total	Small	MLs
1. Domestic private	9.5	10.9	9.8
2. Foreign private	19.3	21.5	19.3
3. Mixed	16.2	22.8	15.9
4. Public enterprise	-1.9	-7.7	-1.6
Total	10.0	11.6	10.3

Source: ILO based on data from ENIA, 1995-1997.

Investment in physical capital and new technologies is a crucial factor in setting productivity goals in the medium and long term. According to the National Statistical Institute (ENIA/INE), the investment rate in small industries is lower than that in medium and large industries. Similarly, according to the Technological Innovation Survey (ITS, 2000), 89 per cent of large enterprises incorporated new electronic equipment in the past three years, whereas only 62 per cent of small and medium enterprises did. They are not incorporating new technologies as fast as large enterprises. Hypothetically, this issue has its origin in cash restrictions and other managerial factors, such as the inability to select and adapt "good investments". Indeed, the ITS shows that 75 per cent of small and medium firms acknowledge their lack of qualified human resources as an obstacle to innovation. In the industrial sector, for example, they also access technical consulting services less than large enterprises (16 per cent vs. 68 per cent) and have less contact with technical institutions (11 per cent of SMEs have some link with information technology compared with 30 per cent of large enterprises).

In other words, the smaller the business, the larger the isolation from (private and/or public) organizations fostering technology upgrading.

According to the SII, in 1997, 11 per cent of total export businesses were micro-enterprises; 28 per cent were small; and 61 per cent were medium and large enterprises. The majority (98 per cent) of the FOB value of exports was also concentrated in medium and large enterprises. This is not surprising given that MSEs were concentrated in the non-tradable sector, such as services and commerce. Since macroeconomic policy has been strongly committed to creating a healthy macroeconomic environment, the real exchange rate showed a constant appreciation until 1998. Real appreciation of the Chilean peso had negative effects for net exporters and positive effects for net importers. MSEs in the trading sector had to deal with external competitors that are becoming stronger because of the changes in the real exchange rate. The partial abolishment of trading barriers and external commerce agreements such as NAFTA and MERCOSUR have also endangered the performance of domestic businesses that cannot compete with imported goods.

### **3. Mapping the institutional environment**

This section maps the policy and legal environment, focusing on the elements affecting economic decisions and employment in MSEs. Those elements of a well-designed policy and legal framework, extracted from the information analysed below, are evaluated in Part 4 of this report.

#### **A. Policy and institutional environment**

During the period of authoritarian government (1973-1989), the authorities' first priority was to increase the country's competitiveness in the world economy. During this political period, the Chilean Government did not show any particular concern for the development of the MSE sector, and did not develop a policy framework manifesto. Nevertheless, the Military Junta retained some of the institutions and programmes aimed at supporting small and medium businesses in operation, regardless of their inefficiency and the prevailing ideology of reducing the size and scope of the State.<sup>28</sup> The first transition government argued that the existing programmes were inadequate. It was also noted that the market alone was not able to give equal opportunities, since some groups lacked information and resources. Thus, the public sector, together with the private sector, had to play an active and improved role in promoting productivity, income levels and worker/employer quality of life in MSEs.

In July 1991, the National Programme supporting small and medium enterprises was implemented. Its aim was to encourage the creation of a platform for the productive development of micro, small and medium businesses. The provision of main services (technical assistance, training, financing, etc.) was entrusted to the private sector, while the public sector kept the decision-making power and the regulatory role. In this context, the National Programme was aimed at enforcing financial access, technical assistance, technological innovation, and export promotion of small and medium enterprises. All programmes in the National Programme had a self-selection mechanism or co-funding structure, which involved the private and public sectors.<sup>29</sup> A list of policies and programmes implemented in the National Programme is presented below.

#### **3.1. Policies and programmes**

##### **Technology and innovation**

Technology and innovation are promoted mainly through the National Fund for Technological and Productive Innovation (FONTEC) of CORFO. FONTEC is a fund to promote, finance and subsidize the implementation of R&D and technological innovation in small and medium enterprises. CORFO acts as a "second-floor" agent through the authorization of five financial lines (which are provided by private financial organizations) to foster innovative projects related to productive technologies, management processes and infrastructure. Line 1 gives financial support for the implementation of technologically

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<sup>28</sup> Román, 2000.

<sup>29</sup> The term self-selection is used since this mechanism ranks the projects in terms of quality. For example, supposing that the "willingness to pay" (expressed in the term "co-funding") is a good indicator of the quality of the project, the demand (the support) would be restricted to those "good" projects for which the group is willing to pay or co-finance.

innovative projects. Line 2 finances infrastructure. Line 3 finances projects of technological missions overseas presented by an association of five or more businesses. Line 4 supports joint projects between five or more non-related businesses (i.e. belonging to different owners) directed to technological modernization. Line 5 finances pre-investment studies of innovative projects for the introduction of technological novelties (either within productive or management processes).

### **Entrepreneurial cohesion**

CORFO also manages programmes directed towards the development of business alliances. First, the “Supplier Development Programme”, carried out by private operators such as ASEXMA, ASIMCA, ASIMET or SERCOTEC, finances up to 60 per cent of the costs of a business which uses a group of 10 SMEs as suppliers (micro-enterprises must apply for a special license given by CORFO in order to access this programme as a supplier). It facilitates subcontracting relationships and the creation of productive chains between large and small businesses. Second, the Development Programme (PROFO) is a group of fostering programmes directed at introducing modern management techniques and/or new technologies in the productive process in groups of at least five small businesses (see Part 4).<sup>30</sup>

### **Technical evaluation**

Technical evaluation adopts a similar logic. Public offices (CORFO, SERCOTEC) authorize projects partially financed by the beneficiary and partially by the Technical Assistance Fund (FAT). The idea is that MSEs can access programmes of financial consultancy (Financial FAT), managerial consultancy (FAT), technical innovation consultancy (PAG) and a special programme aimed at boosting competitiveness among entrepreneurs in the commerce sector.

### **Financial resources**

In the financing area, the 1990s marked a structural change. The State became a “second-floor” agent, guaranteeing loans rather than funding them. Nowadays, financial assistance (loans) is provided by private banks but regulated and authorized by governmental institutions such as CORFO. CORFO lines finance the acquisition of either domestic or imported stocks, such as machinery, equipment, infrastructure, engineering services; they support leasing with a promise to buy domestic capital assets, productive and commercial inputs, for exportable goods in non-traditional sectors. They also give long-term credits to finance foreign purchasers of domestic goods (capital and durable goods), services (consulting) and finance debt renegotiations of small enterprises with private banks and other institutions.

A special public programme aimed at providing funds to micro, small and medium enterprises is the Guarantee Fund for the SME (FOGAPE). It guarantees loans offered by public and private institutions in order to finance investment projects in fixed stocks and/or in work capital. The *Banco Estado* (State Bank) administers this fund, which supports small non-agricultural entrepreneurs whose net turnovers do not exceed UF25,000 per year (about US\$660,000) and small entrepreneur associations.

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<sup>30</sup> For an impact assessment of the PROFO programmes, see Annex 4.

In March 2001, the Government announced a plan to ease financial difficulties in ailing micro, small and medium enterprises. This policy package was instigated because, in spite of the economic recovery after 1999, MSMEs were not improving their economic performance and were not creating the jobs required to stop the trend of increasing unemployment.

The programme used US\$2,200 million in order to increase the availability of new credits and renegotiate current debts. Renegotiations of delayed debt payments were endorsed by governmental guarantees. Regarding bank debts, the programme established an amount of US\$1,000 to renegotiate the debts of small businesses. The renegotiations included a state guarantee of 30 per cent and 40 per cent if the arrangement included new loans for working capital. The programme also increases the guarantee system for small exporters, which will allow new credits to benefit 800 businesses. For micro-enterprises, the programme considers a 50 per cent increase in resources used for financial mediation. This policy potentially benefits 10,000 indebted micro-enterprises. Renegotiations of delayed social security and tax payments are also included in the programme, using interest and fee reductions as an incentive. Debts in social security payments, for example, are payable in 18 months with full cover for the worker. Tax debts were payable in 12 months with no fees or interests being charged.

### **Micro-enterprise support**

In the early 1990s, the Government implemented FOSIS (Fund of Solidarity and Social Investment). This public institution aimed at supporting micro-enterprises and self-employed in alleviating poverty. FOSIS runs special programmes for micro-enterprises. First, through the Credit Assistance Programme, it subsidizes private credits and acts as a third-floor agent, by looking for funds in Intermediary Development Organizations (OID). This programme is aimed at financing the acquisition of fixed assets and working capital in micro-enterprises for a minimum of one year. Second, a programme targeting support for the financial development of rural fishing (through the State Bank) for pre-investment studies and investment if viable and sustainable. The project aims to legalize the sector and introduce it into competitive markets. Similarly, SERCOTEC finances collective and individual projects aimed at improving competitiveness in micro-enterprises. FOSIS also has a training programme that provides skills in production techniques or in business management to micro-entrepreneurs in all economic sectors. This programme consists of a 40-hour training course and a 26-hour technical assistantship conducted in the enterprise in order to discuss several basic topics such as cost and price, sales and promotion, legalization processes and laws.

### **Education and training**

Education and training have been the main public and private priorities during the 1990s, not only for micro-enterprises but also for small and medium categories. The public organization in charge is the National Service of Training and Employment (SENCE), which runs several programmes. The SENCE reform in 1997 created the National Fund for Technological and Productive Innovation (FONTEC) to increase the access to the tax draw-back scheme which is already operating (for all categories of enterprise). This tributary exemption allows the reimbursement of expenditures in training, discounting them from the First Category Tax (see below). The draw-back consists in a maximum of 1 per cent of the total wage; after the reform, if this figure was worth less than 13 UTM (about 6 minimum wages) the enterprise was allowed to discount this same amount. This system shows a cash

flow problem (an enterprise must finance the expenditure in training to be reimbursed in the following fiscal year) that FONTEC has been implemented to solve.

SENCE also supplies a direct subsidy, especially for MSEs, of 26 UTM per year (about US\$1,000), which equals 160 hours of training in order to train employers and workers. In this case, the MSE selects the courses it needs from one of the private suppliers (OTIC, see Annex 1) and SENCE pays OTIC directly (i.e. it is subsidized). There is a grant programme applied throughout the country, which responds to each region's training requirements. It supplies free-of-charge training courses and a small allowance for unemployed people, self-employed or small businesses that do not access other training programmes. It also supplies a short-term labour contract for internships.

### **Export promotion**

The Export Promotion is developed through PROPYME, which is a public project carried out by the *Deutsche Gesellschaft für Technische Zusammenarbeit* (GTZ) and two private institutions: ASEXMA and CONUPIA. The "Chilean SME Promotion Programme" co-finances technical assistantship of international experts in the following areas: external markets, external corporate image, brand development, commercial strategies, quality improvement, production improvement and participation in international trade exhibitions in order to promote domestic products.

## **3.2 Policy environment during the 1990s: Promoting social dialogue**

In the beginning of the 1990s, social dialogue re-emerged. The generation of "National Agreements" was the first sign of the efforts of the Government, entrepreneurs and trade unions to initiate discussion on labour issues. As a result, a tripartite national agreement (*Acuerdo Marco Nacional Tripartito*) was established in 1990, to demonstrate willingness to negotiate – within an established framework – issues affecting socio-economic development.<sup>31</sup> The agreement acknowledged that the open economic model and the private sector were the main engines of economic development and agreed to pay special attention to workers negatively affected by the economic conversion process. During the three following years, other national and sector-level agreements were signed to further contribute to permanent social dialogue (Campero, 2000). This policy ended in 1994 because neither trade unionists nor entrepreneurs were satisfied with the results of the agreement. Nevertheless, this did not prevent other agreements such as the bipartite agreement between workers (CUT) and the Government in 1998, on minimum wage adjustments.

The first period of policy-making aimed at boosting micro, small and medium enterprises (1990-1992) revealed a conceptual disagreement between the Ministry of Economy (MINECON) and the Ministry of Planning (MIDEPLAN, through FOSIS). The former was focused on developing the sector's productivity and on macroeconomic policy and the latter on social policies aimed at alleviating poverty in micro-enterprises. In 1993, the central government delegated implementation to the Ministry of Economy (particularly to CORFO) and ordered MIDEPLAN to abandon their MSE-supporting activities.<sup>32</sup>

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<sup>31</sup> Campero, 2000.

<sup>32</sup> Annex 2 provides a definition of the public and private organizations referred to in this paper.

From 1993 to 1995, two potential social dialogue spaces emerged. First, the CORFO – a public leader in smaller enterprise issues – created a network of medium-sized business corporations to participate in discussion, design and implementation of the programmes. Small businesses, represented by CONUPIA, worked more closely with a different public agency: SERCOTEC. Second, a private organization involved with export businesses (ASEXMA) inspired the creation of the National Center of Productivity (CENAPRO) in 1993. CENAPRO was a tripartite institution aimed at creating social dialogue between the public sector, the private sector and workers. However, this Center was dissolved because of its lack of results and its abandonment by the industrial sector (SOFOFA).

The subsequent attempt to promote social dialogue was the Productive Development Forum, (PDF) created by a Presidential Decree in 1994 as an agreement between government, employers (represented by the Commerce and Production Confederation) and workers (represented by the *Central Unica de Trabajadores*, CUT). This Forum intended through tripartite dialogue, to deal with matters such as economic growth, income distribution, etc. Other participating institutions included members of parliament, politicians, religious authorities, the Army and representatives from the academic world. The PDF replaced the agreement policies operating until 1993. The PDF was relatively successful in creating a discussion space, until 1998, when the actors' disagreement about the modus operandi of the Forum erupted. Workers were looking for short-term agreements, employers wanted to prioritize long-term issues. There were also other criticisms, such as the lack of representation on the entrepreneurs' side, lack of participation on the trade union's side and the exclusive role played by the Ministry of the Economy (MINECON), on the Government's side. Nonetheless, the biggest obstacles for the success of the Forum were the actors' unbalanced bargaining power and participating abilities. The fact that the public sector was represented exclusively by MINECON limited the Government's commitment and responsibility. Moreover, the National Center for Quality and Productiveness (CNPC), created by the Forum, demonstrated that supportive mechanisms in areas such as training and diffusion were positive but insufficient. In sum, the Forum was unable to advance towards participation in the decision-making process, owing to the lack of public sector involvement, lack of resources and the unbalanced bargaining power of actors. In 1998, the Forum's duties were transferred to the Ministry of the Presidency (SECPRES), while CNPC became part of MINECON.

That same year, MINECON announced the creation of the Public-Private Committee (PPC), a social dialogue body exclusively oriented to the development of the micro, small and medium enterprise sector. The PPC has been operating since 1999 with monthly meetings between the Government and employee representatives.<sup>33</sup> This committee gathers representatives from the employers' sector and the public sector (executive and legislative powers). Private participants of PPC are the Chilean SME National Council.<sup>34</sup> This organization is known as CONAPYME, which encompasses CONUPIA, the Truck Owners Confederation, the Chilean Confederation of Retail Commerce (*Confederación Chilena del Comercio Detallista*) and other MSE owner organizations from different sectors. The Manufacturing Exporter Association known as ASEXMA is also a strong participant as well as ASIMET. Among the public sector participants there are representatives from the Ministry of Economy, the Corporation of Productivity Promotion (CORFO), PROCHILE, Bank of the

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<sup>33</sup> Workers' representatives do not participate in the PPC; therefore, it is bipartite rather than tripartite.

<sup>34</sup> Consejo Nacional de la Pequeña y Mediana Empresa de Chile (CONAPYME).

State, the Service of Technical Support (SERCOTEC), the Mining National Business (ENAMI), the National Commission for the Environment (CONAMA), the Fund of Solidarity and Social Investment (FOSIS) and the National Service of Training and Employment (SENCE). Nowadays, it is operating only in the Metropolitan Region; however, it is expected to include other regions in the future. The main objectives of the Committee are to facilitate the implementation of private initiatives, to reach collective agreement regarding public proposals and to find the most favourable way to implement the “The Twelve Commitments of the President to the MSE Sector” provided in Box 3.1. These commitments are an attempt to formalize a policy environment directed to support the micro, small and medium enterprise sector. The PPC meetings are open to the public and records are regularly published on the Ministry of Economy’s web page.

**Box 3.1. The Twelve Commitments of the President to the MSE sector (1999) and steps for implementation**

1. Creating a permanent dialogue committee: The dialogue meetings between the public and private sector (the Public-Private Committee) started in April 2000.
2. Promoting entrepreneurial cohesion: The government supported the implementation of the Micro, Small and Medium Enterprises National Meeting (ENAPE) in order to contact various corporations. Several programmes aim to strengthen entrepreneurial technical abilities, such as the Supplier Development Programme and PROFO (see below).
3. Doubling the resources for programmes fostering smaller enterprises and making funds available for both the commerce and service sectors in 2002; by reassigning funds (which, until 1998 had been subsidizing exporters) to the small enterprise sector.
4. Creating an export promotion fund for small exporters: To support micro, small and medium exporters through tributary and training benefits. PROCHILE (see Annex 1) is already working on improving the Export Promotion Programme for MSMEs (see Part 4). In order to diminish the risk of non-paid exports, a guarantee system (*Sistema de Caucciones*) was implemented in 2000. This system endorses up to 40 per cent of effective exports.
5. Acquainting small enterprise with the academic and technological worlds: The Ministry of Economy is coordinating the third Technological Innovation Programme 2001-2005 for the development of ICT quality, clean production, and biotechnology.
6. Increasing the role of the State Bank in promoting small businesses: By raising funds in order to strengthen the Guarantee Fund for micro, small and medium enterprises, FOGAPE (see below). The State Bank is increasing the number of offices supporting small enterprises; simplifying the paperwork required to obtain credits and is including credits for training, innovation and health insurance. The State Bank also plans to develop a new financial line with better interest rates and time limits.
7. Developing new financial tools for small businesses: By reinforcing FOGAPE, making the risk assessment system more flexible and creating a credit mechanism for entrepreneurs to afford the costs related to use of the SENCE tributary franchise.
8. Creating a law aimed at preventing the abuse of large suppliers over smaller ones. The commission in charge of the Legal Statute is evaluating this issue.
9. Spreading the use of ICTs by subsidizing the demand of PCs and Internet services: For those not able to afford their own PC, the government is implementing info-centres and developing web pages containing information for micro, small and medium enterprises (Sitio Empresa, Zona Empresa y Red Sercotec).
10. Reducing paperwork to achieve the formal establishment of businesses in one week: By implementing the programme “Paperwork simplification for the registration of businesses in city councils” (see Part 4).
11. Protecting domestic products from disloyal competition by cheap imports.
12. Fight against delinquency and its effects on small businesses.

### 3.3 The legal framework

Several instruments give a legal framework to MSEs. The Code of Commerce controls the creation, modification and operation of businesses. The Labour Code<sup>35</sup> regulates labour relationships between employers and employees. The Tax Code and the Income Law establish the tax obligations of businesses, employers and employees. Nevertheless, these legal instruments govern all types of private businesses regardless of their size; the Chilean legal framework makes no distinction between the regulation of micro, small, medium or large enterprises. Some laws tangentially affect MSEs, for example, regarding the creation of trade unions. Article 209 of Law 18.620 stipulates that at least 25 workers (representing 10 per cent of total employees) are required to create a union. In businesses with less than twenty-five workers, the union requires at least eight workers (representing more than 50 per cent of employees). Another example is nursery facilities: Article 188 of Law 18.620 stipulates that all businesses with 25 or more women workers should provide a child care centre. Since it is unlikely that small businesses would hire this number of women workers, many women choose to work as self-employed or at home, in order to make their job and household duties compatible.

Although during the 1990s micro, small and medium enterprises became an important topic on the country's agenda, the legal framework has not mirrored this increased attention. For example, laws and regulations for MSEs are practically identical to those controlling medium-sized and large businesses, the only exception being some special provisions in tax payment. In addition, several public institutions (city councils, the internal revenue service (SII), the National Commission for the Environment (CONAMA) and the Environmental Health Service (SSA) manage the legal and administrative requirements in the legal framework at both national and regional levels. This system often lacks coordination and involves plenty of paperwork and doubles up on requirements to be fulfilled. A list of all these legal and administrative requirements is given below to illustrate the complexity of the legal framework – for all enterprises, be they large corporations or micro-enterprises.

#### **Business regulations<sup>36</sup>**

In order to create or modify the business, the entrepreneur must choose between two legal structures: either to be an individual entrepreneur or to create a partnership in any of the forms described below. The decision depends on several variables: number of partners, availability of capital and access to credit. The entrepreneur chooses to work as an individual entrepreneur if he or she prefers to work alone and has the financial support to develop the initiative through credit or own funds. Or the entrepreneur may opt to create a partnership in which two or more individuals and/or businesses are linked by a contractual agreement to share the gains and are responsible for the losses of the business. If something has not been established within the contract, the law will fill the gaps. The partnership constitutes a legal person, that is, a fictitious entity able to commit to civil rights and duties (independently from its partners) and able to be judicially and non-judicially represented. A partnership is independent from its members, it has its own name, capital, address and nationality and is

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<sup>35</sup> Law No. 18.620, published on 6 July 1987, approves the Labour Code.

<sup>36</sup> On this topic, the *Confederación de la Producción y el Comercio de Chile* published a guidebook for SMEs with technical and financial support from the ILO (CPC/ILO, 2000).

considered an individual before the law. The Chilean legislation contemplates several legal structures for enterprises.<sup>37</sup>

*Sociedades Colectivas (Collective partnerships), either civil or commercial*

The administration of the partnership is done either by all the partners or by an elected member. The responsibility of the partners is unlimited (in case of malfunction, partnerships must commit their patrimony to fulfilling the partnership's obligations) and each member contributes either in equal parts or to the extent that he or she can contribute.

*Sociedad de Responsabilidad Limitada (Limited liability partnership)*

This partnership is similar to the collective partnership, with the difference that responsibility of partners is limited to the amount they have actually contributed. If partners have not made the contributions they committed to, responsibility turns to unlimited (see case above). *This has been the recommended structure to create an MSE, because it liberates partners from committing their own capital in order to pay for the partnership's liabilities.*

*Sociedades en Comandita (Silent partnership)*

Partnership between a person (or group of people) contributing with capital and a person (or group of people) administering the association. Thus, there are two kinds of partners: the manager and the silent partners. The "manager partners" administer and respond with all their assets and capital to the partnership's liabilities. The "silent partners" contribute an amount of capital and their responsibility is limited to the amount they have contributed.

*Sociedad Anónima (Anonymous partnership) either open or closed*

This is defined as a legal person formed by the capital (stock) contributed by partners, whose responsibility is limited to that amount. An open anonymous partnership, publicly supplies its stocks, has more than 500 stockholders, and at least 10 per cent of its capital belongs to at least 100 stockholders.

*Sociedad de Hecho (de facto partnership).*

This is any association that does not fulfil at least one of the legal requirements. Although common, it is not recommended for creating an enterprise because it does not protect the private assets of members.

Once the micro or small enterprise has chosen its legal structure, it has to comply with a series of requirements. The main formal procedures described below are classified according to the relevant institutions.

*City councils:* The local government grants a "Local Permit". In order to obtain this permit, the business must fulfill a list of requirements. These are: an authorization of the Electricity and Fuel Superintendence and a sanitary authorization from the Health Service (see Annex 1). The business also needs to have an address (SII), to legally constitute the partnership (Civil Register), to legally declare the amount of initial private capital, to initiate operations (SII) and to obtain a report of the *Dirección de Obras Municipales*.

*Internal Revenue Service (SII):* The Internal Revenue Service deals with officially registering the business in terms of tax payment. A business is official when it has

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<sup>37</sup> A new legal status is the family-owned micro enterprise, which benefits from simplified procedures to obtain the permits from local authorities (Law No. 19.749, in force since 2002).

accomplished the following paperwork: legalization (sealing) of documents, address confirmation and start of operations.

*Metropolitan Environmental Health Service (SESMA)*: The Health Service oversees environmental provisions. To comply with the law, a business must carry out two main requirements. First, comply with special requests of the “Decontamination Plan” and second, comply with regular requirements regarding waste and dangerous substances, atmospheric emissions, noises and minimal conditions in the work place (bathroom fittings, hygiene and safety). In order to obtain or officialize a permit, the business must obtain a sanitary report. It must also obtain a technical qualification report (SESMA classifies the project as dangerous, unhealthy, polluting, disturbing or innocuous). In addition, a business that is located in the city of Santiago must check whether the project is in agreement with the use of land established by the City Council Plan of Geographical Regulation.

### **3.4 Labour laws**

The Chilean Legislation includes two legal forms of incorporating workers, the labour contract and the service agreement. The *service agreement* operates when there is a free agreement between the worker and the employer, which lasts until the work is completed; is not governed by any code and does not consider any insurance payment (for pension or for health). The employee keeps 10 per cent of the gross salary for tax purposes. The employee is not obliged to follow a schedule and is not directly supervised (the worker is independent). The service agreement does not constitute a labour relationship; thus, it allows more flexibility for the employer. This is a very easy-to-create contract that binds all areas of conflict between workers and business owners.

The *labour contract* can be individual or collective, indefinite or for a fixed term. It establishes an agreement by which the employee undertakes to carry out the tasks described in the contract and the employer undertakes to pay the worker a certain amount of money in return. This is a consensual agreement wherein the employee depends on or is subordinate to the employer. According to law, the parties involved in the labour contract cannot withdraw from the rights established in it. It has the following requirements:

- It must be written before the employee has completed 15 days of work (5 days when the employer is hiring the worker for less than 30 days). The employee must sign and keep a copy of the labour contract. When the written contract is missing, it is the declaration of the employee that rules the content of the contract.
- Working hours cannot exceed 10 hours per day or 48 hours per week.<sup>38</sup> Workers without immediate supervision are excluded from this rule.
- It considers several types of wages as listed below. Types a, b and c are compulsory. In order to control the payment of salaries, any business employing more than 5 workers must complete a book to be signed by the Internal Revenue Service.
  - a. Fixed salary: Cannot be below the minimum wage. Taxes, social expenditures in health and pensions and other payments such as union fees are deducted.

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<sup>38</sup> There are some exceptions: Christmas, national holidays, etc. when working hours may be extended by 2 hours per day. However, if working-time exceeds 48 hours per week, overtime must be paid.

- b. Overtime must be paid for additional hours worked.
  - c. Bonus: either 30 per cent of enterprise profits or 25 per cent of wages with a maximum of 4.75 minimum wages per month.
  - d. Commission: a share of turnover, sales or other operations
  - e. Participation: a share of business profits.
- Includes a maternity code, which establishes that pregnant workers have a compulsory maternity leave of 6 weeks before and 12 weeks after childbirth (should the mother die during delivery, this right is transferred to the father). This period can be extended in case of illness. During these periods the worker receives a subsidy equal to her net salary. The employer cannot fire a pregnant worker, either during the leave period or during the following year.
  - Identifies the events triggering the end of the labour contract: personal matters (an agreement between the employer and employee and the employee's resignation) and impersonal matters (reasons beyond the will of the parties). When the contract terminates for impersonal matters, the employer is not obliged to pay compensation or unemployment payments. When the contract is terminated on the part of the employer, the employer must pay one month per year of service, with a maximum of 11 months or 90 UF. The employer must notify the dismissal decision 30 days in advance.
  - Identifies employees protected from dismissal: pregnant workers, female employees within 12 months after the birth of the child, union leaders and representatives, workers involved in a process of collective bargaining, workers on sick leave and workers doing military service.
  - The Labour Code obliges dependent workers to affiliate to one of the privately managed institutions that belong to the private pension system. These are the Pension Fund Administrators (AFP), which were created in 1980. The AFP is responsible for the following benefits established by law: retirement pension (65 years for men, 60 for women), disability pension, pensions for surviving relatives and the mortuary quota for the person paying a worker's funeral expenses. By law, 13 per cent of the employee's gross salary goes to this pension fund. The employer must make these deductions since, by law, employers must declare this amount. Independent workers are free to choose whether to be affiliated to AFPs or not.
  - Regarding the health system, employees must pay at least 7 per cent of their gross salary either to the private health system (Private Health Insurance, ISAPREs) or to the public system (National Health Fund or FONASA). As with pension payments, health payments must be deducted by the employer.

### 3.5 Tax laws and MSE tax structure

The Chilean Tax System consists of several types of taxes. First, businesses must pay the “Sales and Property Taxes”, which are the Value Added Tax (VAT) and the Territorial Tax (TT). Regarding the VAT, 18 per cent of the sales value goes to the Internal Revenue Service (SII). Businesses actually pay the difference between the fiscal debit – the amount it has collected from sales – and the fiscal credit, i.e. the amount of taxes and tariffs (for imported inputs) it has paid when buying. The TT affects 1.425 per cent of the property value. Second, businesses pay the following types of “Income Taxes”: the First Category Tax, 15 per cent of profits of activities under Article 20 of the Income Law;<sup>39</sup> the Second Category Tax, for dependent workers (affecting wages, salaries and pensions); the Global Complementary Tax, for non-dependent workers, and; an additional tax affecting 35 per cent of total withdrawals of any Chilean source of income by an individual or company with no residence in Chile. Some businesses must also pay other taxes, such as a tax on alcoholic and non-alcoholic beverages, special taxes on automobile imports, tobacco, cigarettes and fuel, stamps, etc. Import taxes are uniform for most products; the tariff rate was 11 per cent until 1998. This rate was reduced to 9 per cent and is expected to decrease by 3 more points by 2003. Some foreign products competing with domestic products are charged specific tariffs.

Once the MSE has initiated operations, it must pay non-income and income taxes. The payment of taxes varies according to the economic activity, the size and the legal structure of the business. An interesting feature is the difference between the three income tax regimes in force, which relate directly to business size: the Regular Regime, the Simplified Regime and the Small Taxpayer Regime.

The **Regular Regime** includes all taxes in the regular system with some exemptions regarding the size of the business. In relation to the First Category Tax, the exemption is for small taxpayers contributing under the “*Renta presunta*” system<sup>40</sup> and businesses with a net capital profit below US\$5,500. These businesses, usually MSEs, are exempt and, anyway, this payment is a credit for the tax paid by the business owner. Such a personal tax could be the Global Complementary Tax or the Additional Tax, depending on where the business is located.<sup>41</sup> Regarding the Second Category Tax, every month the entrepreneur must withhold and pay a progressive fraction of the salaries of workers who have a contract (dependent workers).<sup>42</sup> The Global Complementary Tax must be paid by independent workers and

<sup>39</sup> Operating real estate, personal assets, commerce, industry, mining, construction and services, mediating services, education, health, leisure, and any other service activity.

<sup>40</sup> They are small taxpayers from the agriculture, mining and transport sectors who declare ‘No income’ under the First Category Tax.

<sup>41</sup> It is assumed that all MSEs have residence within the national territory. Thus, this additional tax is not analysed.

<sup>42</sup> The Second Category Tax and the Global Complementary Tax have a progressive structure (i.e. the UTM value is approximately Ch\$27,000 or US\$ 45):

Earnings per month in UTM	%
Less than 10	Exempt
10 to 30	5
30 to 50	13
50 to 70	23
70 to 90	33
90 to 100	35
100 to 120	45
120 or more	48

“Professional Societies”, when choosing to pay taxes in the Second rather than in the First Category.

The **Simplified Regime** (Article 14 bis) rules small taxpayers whose annual turnover does not exceed 3,000 UTM (US\$135,000), and those who have recently initiated operations with a starting capital under 200 UTM (US\$9,000). The system demands paying a single tax: the First Category Tax or 15 per cent over any profit withdrawn from the business whatever origin this profit may have (even those not classified as income).

Finally, the Chilean system includes a **Small Taxpayer Regime** (Article 22 – Income Law). It is for small taxpayers who are allowed to pay taxes with a single tax paid annually. For example, small street traders might choose to pay a fixed amount of 0.5 UTM (US\$21); newspaper and magazine sellers are allowed to pay 0.5 per cent of their total turnover or 0.5 per cent + 0.25 UTM (US\$11) if they also sell cigarettes, lottery numbers, candies, etc. Small self-employed workshop owners, with an effective capital below US\$5,400 or employers who hire five or less workers, including relatives and apprentices, pay only the highest amount between 2 UTM (US\$90) and the Global Complementary Tax.

### 3.6 Sources of finance

Generally speaking, MSEs have good access to loans from the private sector.<sup>43</sup> Regarding financing programmes, the public sector acts as a mediator between the enterprise and the private institution. It is always the private bank that evaluates the risk, establishes the interest rate and sets the general terms of credit. In order to be successful in the commercial evaluation, the business must prove payment capacity and profitability. Since many MSEs do not fulfill private requirements, the public sector mediates and sometimes guarantees private sources. CORFO provides financing backup through the evaluation and authorization of long-term credits, which are provided by private institutions.

Private institutions have several mechanisms designed to finance a requested investment or to respond to short-term obligations directly related to business operations. For example, working capital is financed through short-term (30-, 60-, 90-day or 1-year) loans and there are other products such as the discount of bills of exchange and overdrafts. Another example is the special credit for micro-enterprises (*Crédito extraordinario para microempresas*), which anticipates bills of exchange. A private institution operates this loan<sup>44</sup> once the MSE has fulfilled certain conditions. In order to obtain a credit, the business must become a member of the cooperative society, be a property owner (otherwise, real guarantees are required), show favourable commercial records, and have an annual turnover over US\$17,000. SMEs can access a wide range of credits directed to finance the acquisition of

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<sup>43</sup> Public and private institutions which provide financial support to micro and small enterprises are banks such as: A. Edwards, ABN Amro Bank, BBV BHIF, BICE, Chile, de la Nación Argentina, Desarrollo, Internacional, Real, Santander, Santiago, Security, Sud Americano, Sudameris, Boston, BCI, Citibank, Corpanca, Banco del Desarrollo, Banco del Estado de Chile, Bandedarrollo Leasing, Banedwards, Sogeleasing, BCI Leasing, BHIF leasing, Cía General de leasing, Citibank, Corp Leasing, Leasing Andino, Leasing Nacional, Leasing Progreso, Leasing Security, Leasing Sud Americano, Santander Leasing, Santiago Leasing, Valparaíso Leasing, Cooperativa de Ahorro y Crédito Liberación Limitada, Banco Santander Chile, Banco de Chile Corporación de Promoción para la Pequeña Empresa, PROPESA, BanEstado Microempresas S.A., BanDesarrollo Microempresas, Inversiones para el Desarrollo INDES S.A., BanEdwards Sogeleasing S.A, BCI Leasing, BanDesarrollo Leasing, Banco Mundial de la Mujer.

<sup>44</sup> DETACOOP LTDA: Cooperativa de ahorro y crédito “El detallista Ltda.”

productive goods identified as “own capital”. For exports and imports, several short-term credits in foreign currency are available, which finance expenditures related to foreign trade.

### **3.7 Foreign trade**

As Part 2 explained, most exports are concentrated in medium and large enterprises. The legal procedure for carrying out exports and imports is complicated.<sup>45</sup> However the exporter can ask for benefits to promote exports: the Simplified Refund to Non-traditional Exports (Law No. 18.480, D.o. 19/12/85), the Refund of Rights and other Customs Burdens (Law No. 18.708, D. 13/05/88), the Refund of the Value Added Tax, I.V.A. (Decree Law No. 825, D.o. 13/12/74)<sup>46</sup> the deferred payment of Customs Burdens and Fiscal Credit Applicable to Capital Assets and their Amortization with Exports (Law No. 18.634)<sup>47</sup> and the Guarantee Fund For Non-traditional Exports (Law No. 18.645).

To follow up on the above description of the policy and legal framework for MSEs in Chile, Part 4 now assesses the existing biases in the institutional environment and their impact, as well as the identification of examples of good practice.

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<sup>45</sup> There are four actors who take part in an export operation: the exporter, the importer, the bank which issues the credit letter overseas and the Central Bank in Chile. The exporter must follow several procedures before exporting. The exporter must register in the Central Bank of Chile as an “Exporter” and contact the buyer in order to provide samples and a list of prices. Once the buyer signs the terms of supply, the agreement is detailed in a letter of credit, which is opened by the foreign bank. The Chilean commercial bank reviews and confirms the letter of credit for the exporter to negotiate the Report of Export with the Central Bank of Chile. Then the exporter sends all the required documents (export report, invoice of export etc.), including the Mandate (document authorizing the exporter’s representative Customs agent) and the Note of Boarding so that the Customs agent approves the embarkation of products. Once the merchandise has been embarked, the Carrier Company or the Agency of Customs must sign the shipping order. Within the next 25 days, the dispatcher must hand in the Declaration of Exportation. The exporter submits the boarding documents to the commercial bank for its revision. If it is accepted, the bank carries out the corresponding payments or quotas. Finally, the exporter must inform the Central Bank of the destiny of the foreign currency up to 270 days after the embarkation of the product.

<sup>46</sup> When the exporter also sells in the internal market, the VAT reimbursement takes place through the fiscal credit.

<sup>47</sup> This law has two benefits: a) With certain merchandise, considered capital assets, payment of the customs tariffs can be delayed up to seven years; b) People who obtain domestic capital assets as a first transference (first hand) can apply for a fiscal credit of 73 per cent of customs rights, which would be imposed on them as if goods had been imported.

## **4. Evaluating the institutional environment**

The two main features that characterize the policy and legal framework in Chile are: 1) on the one hand, public programmes that promote the micro and small enterprise sector require MSEs to have access to privately provided public facilities; and 2) on the other hand, the legal framework is complicated and, more importantly, regulations do not differentiate by enterprise size. That being said, Part 4 identifies selected policies as “good practice” in terms of the development of MSEs as dynamic sources of decent jobs. It also identifies the forces that are increasing the gap between good practices in the decision-making process and good practices in the implementation process. Detecting these forces provides orientation for future policy-making. The main sources of this analysis are public documents, the ILO MSE Survey and the opinion of key interviewees.<sup>48</sup>

### **A. Evaluation of the policy environment**

In this research, social dialogue has been emphasized. It has been argued that in liberal democracies, the main strategy to boost competitiveness is by introducing MSEs into the market rationale. Promoting participation in social dialogue instances is one way of doing this. However, the public bodies established to promote social dialogue on micro, small and medium enterprise concerns have not satisfactorily fulfilled their responsibility to micro and small enterprises, since MSE participation has not been adequately developed.

Regarding the introduction of MSEs into the market rationale, we have selected as “good practices” the policies promoting entrepreneurial cohesion. This encompasses introducing MSEs into the logic of the new economy, enhancing the knowledge of their own needs, fostering proactivity and an effective participation in social dialogue. Promoting cohesion means reinforcing the sector as demanders. During the 1990s, the public sector subsidized demand; thus, the focus of public support depended on the demander’s strength and ability to compete with other demanders for scarcely supplied resources. Isolation has prevented MSEs from accessing information and collecting experience in order to perform as good demanders. This situation has given shape to a system in which MSEs play the role of the “assisted group”. However, social and economic transition requires MSEs to play an active role in their own development.

Evidence of the ILO MSE Survey 2001 confirms that MSEs are often isolated. First, they are seldom affiliated to entrepreneurial organizations. Only 7.5 per cent of micro and 12.9 per cent of small enterprises were members of this kind of organization. Further, MSE activity is mainly localized: only 12 per cent of micro and 32 per cent of small enterprises accessed the market at a national level. Only 0.6 per cent of micro and 5 per cent of small enterprises accessed the international market. MSEs obtain information about market performance mainly through newspapers and professional consultants (70 per cent of MSEs); while sharing experience with other entrepreneurs is not common among micro and small enterprises (12.4 per cent and 7.2 per cent respectively). Only 3.1 per cent of micro and 10.1 per cent of small enterprises have heard about the Public-Private Committee; 20 per cent and 43 per cent respectively are aware that the PPC has information available on what happens in their monthly meetings. Similarly, 14.3 per cent and 29.5 per cent respectively are aware of the

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<sup>48</sup> Evaluation of the policy environment.

“Twelve Commitments of the President to the MSE sector”. Of these entrepreneurs, 26 per cent and 22 per cent respectively perceive these commitments as being fulfilled. These indicators show that isolation and misinformation is common in micro and small enterprises.

In order to overcome isolation, the main public policies which boost entrepreneurial cohesion of MSEs are the Development Programme (PROFO) and the Export Promotion Programme (INTERPYME). Other elements directly affecting MSE competitiveness, such as training facilities, are also evaluated below.

#### **4.1 Boosting entrepreneurship and productivity: PROFO**

This analysis highlights two features of the PROFO programme: the effects of the programme on the generation of “entrepreneurial culture” with solid networks and precise goals, and the impact of the programme on productivity.

This programme incorporates entrepreneur proactivity, public financial aid and technical support of private operators. The State, through CORFO, becomes a “second-floor” agent, by authorizing projects designed by PROFO or the group of businesses participating in the programme. A PROFO creates common projects and must compete for obtaining resources from different public programmes such as the Technical Assistance Fund (FAT) for consulting businesses or the National Fund for Technological and Productive Innovation (FONTEC) for technological development. The operation of the programme is given to an authorized private organization (there are 16 authorized operators and 1 public agency, SERCOTEC). The PROFO is in charge of assisting small and medium-sized enterprises in creating an association of entrepreneurs to meet their own needs in the way they prefer. For example, through the programme, CORFO co-finances up to 70 per cent of the cost of an innovative programme to improve competitiveness. The co-financial system acts as a self-selection mechanism, which highlights the importance of the strength of the group as a demander. In general, the projects are aimed at solving management, production or other problems such as economies of scale (i.e. problems which are better solved as a group). Box 4.1 provides an example in the city of Valdivia.

##### **Box 4.1 PROFO: Boosting entrepreneurship and productivity in metalworking enterprises in Valdivia, Chile**

The PROFO project gave birth to the Metalworking Industrial Union of Valdivia (*Unión de Industriales Metalmecánicas de Valdivia*). In 1996, a woman entrepreneur arranged a meeting with some of her colleagues in the industry, to create a dialogue concerning the sector’s perspectives and the best way to overcome common problems. Ten businesses met together and created a PROFO in order to solve their problems collectively. They became a complementary group which provided an integral service to the metalworking sector. The PROFO has included training programmes to improve the productive process. It has also offered courses for personal development in order to improve managerial skills. This project has been positively evaluated in terms of raising income, improving industrial know-how and creating awareness of the sector’s requirements. Not all businesses enjoy the same success or participate to the same extent. In similar programmes, a strong tendency to spill-over effects or free-rider behaviour has been observed. However, in this particular PROFO in Valdivia, participants declared that “idle” businesses will eventually take the right in order to remain as a competitive part of the PROFO.

Although the PROFO is mainly aimed at boosting productivity, the externalities of the programme can be seen in the creation of associations that help participants improve access to internal and external markets, generate technology transfer, adopt modern management techniques and contribute to local development. The PROFO also generates opportunities for joint learning, improves bargaining power and creates new production chains.

Participants in PROFO confirmed that, in the management area, the programme has been effective in improving the organization of work, marketing strategies and focus on production. According to participants, the most remarkable innovations the PROFO has introduced have been quality control and automation. In the area of human resource management, the benefits mentioned by participants include more opportunities to train managers, workers and administrative staff (in that order). Finally, the programme has been positively evaluated by beneficiaries for having improved the access to other public and private initiatives aimed at improving productivity. It has also been demonstrated that productivity in participating businesses has increased between 11.8 per cent and 14.4 per cent after the PROFO.<sup>49</sup>

The problem is that only a few small enterprises are accessing this kind of programme because of the sector's overall lack of information and lack of organization. In 1997, for example, CORFO approved 303 projects comprising 3,404 SMEs.<sup>50</sup> Furthermore, according to the ILO MSE Survey, the programme is known only by 8 per cent of the potential beneficiaries in small enterprises.

#### **4.2. Introducing small enterprises into the New Economy by means of export promotion**

The Foreign Office, through PROCHILE, has recently developed InterPYME, a programme aimed at generating the required skills in SMEs<sup>51</sup> to successfully perform export activities. The objective is to introduce 1,000 new businesses into the Chilean export process by 2005 by providing small enterprises with the knowledge of the requirements of export markets. This will enable enterprises to learn about the export process and to evaluate whether this is the best option for them. This programme is still in the planning stage; however, this paper views this initiative as a good practice because its aim is to introduce small enterprises to the logic of the new economic model (mainly determined by the open market).

Participating businesses are expected to increase their ability to implement internationalization strategies. The programme is publicly run by PROCHILE in cooperation with CORFO and private employer associations. They act as tutors in the export process by fostering a cultural change within the business and promoting a learning process of proactivity. The programme also aims at creating a cultural change in terms of the relationship between the business and the public sector since it implies that both actors must work together. However the final decision and responsibility belong to the business. The programme comprises all regions and economic sectors throughout the country.

There are two stages in the programme. The first stage, called the pre-internationalization phase, lasts two months. During this first stage, the business must evaluate

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<sup>49</sup> For a description of the methodology in the qualitative and quantitative analysis of the PROFO, see Annex 5.

<sup>50</sup> Similarly to other programmes, PROFO is directed to small and medium enterprises as a whole. It is impossible to differentiate the size of the beneficiaries of PROFO.

<sup>51</sup> Micro enterprises do not have access to this particular initiative.

the degree to which it is prepared to access the external market, detect its strengths, weaknesses and its willingness to export. It also needs to evaluate the sector and its own relative position, to determine if exporting is the best strategy. The second stage lasts between 8 and 10 months. During this period, the business develops the strategic plan in terms of number of markets, access strategy, information requirements, etc. Afterwards, the programme has a period of two years in which the business must apply for further tutoring from the public office in charge. The business must make a product which can be internationally commercialized and have at least 10 workers.

The programme finances 70 per cent of the tutorial expenditures (25 and 80 hours of tutoring in the first and second stages, respectively) and export promotion expenditures (missions, visits to external markets, etc.). The programme also finances 50 per cent of the cost of hiring a consultant, if necessary.

### **4.3. Education and training**

Data analysis shows that workers in MSEs are less qualified than workers in medium and large enterprises (as described in Part 2 of this report). Micro and small enterprise workers have, on average, fewer years of education than workers in medium and large enterprises and professionals and technicians are relatively less represented in the MSEs.

During the military government, in 1976, the Statute of Training and Employment was promulgated. By means of this law, the State dropped the training-supplier role<sup>52</sup> adopting a “second-floor” role, aimed at regulating, financing and monitoring training. Training provision was delegated to private entities (Authorized Training Organizations, OTIC) and training was financed through a certified system or tax rebate. Getting the private sector involved in the provision of training programmes is a positive pathway that has promoted quality improvement and spread training opportunities to all regions and economic sectors. Nevertheless, the tax drawback scheme has not been adequately used. In 1992, only 2 per cent of businesses registered in the Internal Revenue Service used the facility. 49 per cent of them (around 3,300 businesses) used the entire amount of money available from the scheme. Also, during 1988 and 1992, large businesses used 80 per cent of the funds of this franchise; medium businesses used 14 per cent of the amount, compared to 5.1 per cent used by MSEs.

Since the promulgation of the Statute of Training and Employment, training has been concentrated on workers with more years of education. In 1996, 17 per cent of training programmes were used by professionals, 12 per cent by managers at a medium level, 34 per cent by administrative staff, 29 per cent by qualified workers, 6 per cent by less qualified people and only 2 per cent by non-qualified workers. Less educated workers tended to concentrate in MSEs; thus, the majority of users belonged to large enterprises.

A major reform of SENCE was introduced in 1997 to widen the availability of training programmes and to boost the participation of workers in the decision-making process regarding training issues. The tax rebate corresponds to 1 per cent of the business’ salaries per year (*Planilla Anual de Salarios*). The reform establishes that, when this amount is lower than around US\$530, the enterprise can deduct up to this amount from its taxes for training purposes.

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<sup>52</sup> Until 1976, the public sector had provided training facilities through the National Training Institute, INACAP.

Since the funds related to the tax rebate scheme are recovered only at the end of the tributary year, the system generates cash flow problems, mostly for MSEs. The new reform establishes training credit for MSEs, which equals the total value of the franchise. The credit must be paid up to 18 months, and has a fixed interest rate. In order to access the credit, the enterprise should belong to the MSE sector, not have pending tax, social or labour infractions and must have favourable commercial records. Workers must have a contract and the employee must comply with social laws (i.e. pay the 20 per cent of the worker's gross salary to the health and social security funds).

The reform also considers the creation of a National Fund for Employee Training (FONCAP) in order to subsidize training in MSEs. This subsidy finances up to 26 UTM per year (about US\$1,000), which equals 160 hours of training provided by private suppliers (OTIC). In order to obtain this subsidy, enterprises must have an annual turnover below 25,000 UTM (US\$500,000), be at least 18 months old, not have tax or labour infractions and prove that trainees are workers in the enterprise (i.e. have a signed contract). FONCAP also finances a grant programme applied throughout the country, which responds to each region's training requirements. It supplies training courses free-of-charge, as well as a small allowance for the unemployed, the self-employed or to small businesses. It also provides short-term labour contracts during internships.

In spite of all these public incentive schemes, the data demonstrate that the situation remains similar to earlier years. The training programmes – relating to the tax rebate scheme – still concentrate on administrative staff and qualified workers (80 per cent in 1998) whereas unskilled workers represented less than 5 per cent of trainees in 1998. This suggests that MSEs are still not using the scheme. Moreover, according to Table 4.1, the larger the enterprise, the larger the percentage of workers attending training programmes. Social programmes are more common for micro-enterprises (19.6 per cent of total trainees) than for small businesses (10.6 per cent of trainees) and medium and large enterprises (5.2 per cent of trainees). Survey data provide several reasons why MSE workers do not attend training programmes. Lack of time is a very common factor for businesses of any size. However, this seems to be a less valid reason for workers in medium and large enterprises. One significant aspect is that 23.6 per cent of workers in micro-enterprises surveyed are not interested in attending training programmes (lack of interest diminishes in larger businesses). Lack of financial resources is another important reason for MSE workers. Lack of information about where and how to access training programmes prevents 12 per cent of workers in MSEs from accessing training programmes.

**Table 4.1. Workers attending training programmes and reasons for not attending, 1998**

	Self-employment <sup>a</sup>	Micro <sup>b</sup>	Small <sup>c</sup>	ML <sup>d</sup>
Workers attending training programs last year (% of total employment in each category)				
Through enterprise	...	57.4	72.5	85.9
Through social programmes	...	19.6	10.9	5.2
	...	23.0	16.6	8.9
Workers not attending training programmes last year (% of total employment in each category)				
Reasons for not attending				
Does not have any time	43.3	47.3	50.1	49.7
Lack of interest <sup>e</sup>	26.7	22.8	19.9	19.5
Lack of financing	10.9	11.0	11.6	9.9
Lack of information	12.4	10.0	9.0	7.9
Other reasons <sup>f</sup>	5.5	8.0	8.5	12.4
Total	98.8	99.2	99.2	99.4

Notes: <sup>a</sup> Self-employment and one-person businesses; <sup>b</sup> non-agricultural workers in 2 to 9 people enterprises; <sup>c</sup> Non-agricultural workers in 10 to 49 people enterprises; <sup>d</sup> non-agricultural workers in enterprises with over 50 workers; <sup>e</sup> as training programmes do not improve quality of jobs or career perspectives, workers perceive no need to attend; <sup>f</sup> These include previous bad experiences, or the worker does not feel prepared; is currently studying or does not have employer's permission.

Source: CASEN, 1998.

Among other obstacles, information asymmetries and cultural beliefs prevent MSE workers from taking up training opportunities. It has been demonstrated<sup>53</sup> that beneficiaries of the national training system – mainly MSE workers – lack information about the availability of training facilities and the institutions managing these resources. When asked, MSE entrepreneurs note the inadequacy in the communication mechanism and the need of an institution which centralizes the certification of the privately provided programmes. Training is positively evaluated by entrepreneurs since it enhances competitiveness. However, training is also viewed negatively since it is perceived to raise labour costs and endanger the relationship between employers and employees. Handing over responsibility is negatively evaluated as “loss of control”; often entrepreneurs do not trust their employees, inducing them to stop training. In general, entrepreneurs want to directly monitor and coordinate the production processes, which diminishes the employee demand for training.

The SENCE reform implements committees or bodies of social dialogue (at national, regional and business levels) in order to boost the participation of trade unions in training decisions. In 1999, 10 per cent of businesses using the tax rebate scheme actually made joint training decisions between employers and employees. However, MSEs usually do not access these social dialogue institutions, because workers lack organized representation.

## **B. Evaluation of the legal framework**

In Chile, the legal environment does not differentiate enterprises by size. All businesses must fulfil the same legal requirements according to their economic sector and geographic location. Legal procedures are time-consuming, repetitive and involve multiple visits to public offices. Sometimes paperwork is facilitated by contacts at city councils; this

<sup>53</sup> Fundes Chile, Adimark, 1999 carried out focus groups with entrepreneurs in MSEs.

accelerates the approval of local permits. Since many MSEs lack resources to afford the costs of obtaining a local permit, they are more likely to remain unregistered, which endangers the source of jobs.

In 2000, the PPC<sup>54</sup> proposed the creation of a Special Legal Statute for the micro, small and medium enterprise sectors, aimed at institutionalizing a special code and policy framework for their productive development. The assumption underlying this proposal was that their broad economic and managerial heterogeneity is not taken into account in the current institutional framework. Micro, small and medium enterprises are weaker than larger businesses and have difficulties in complying with legal requirements. Regarding the protection of the environment and the issues of labour, health, tax and also local issues, the requirements are too many. The objectives of the Legal Statute are: to promote the economic development of SMEs (in order to reach, by 2010, similar income levels to those in developed countries); avoid monopolistic practices and guarantee the existence of competitive markets in each economic sector; broaden the productive base and enhance entrepreneurial skills and creative power outside the capital city (Santiago) and in less advanced city councils and regions; and contribute to achieving the Twelve Commitments of the President (for a detailed description and evaluation of the Legal Statute for MSEs, see Annex 6).

The Ministry of the Economy developed a device (the “*tramitometro*”) in order to measure the complicated paperwork required to officially register a business. Table 4.2 shows processing of paperwork in 310 city councils (from a national total of 341). Although the information is not classified according to the size of the business, it is understood that the indicators are worse than the average for MSEs. According to the “*tramitometro*”, the average number of days required to obtain the license is 26.3 for industrial activities, 17.3 for commercial activities and only 4.4 for professionals. Some city councils take as many as 313 days to approve a license, whereas others take only 1 day. The average number of required documents is 5.7 for industrial businesses, 5 for commerce and 3 for professionals. Some city councils ask for 28 documents in order to endorse a permit. On average, the number of forms requested to be filled in is lower for professionals (1.3) and higher for the commerce sector (around 2). Finally, an entrepreneur must go from one place to another 2.1 times (professionals) and 3.3 times (commerce) on average. Some businesses must go 10 times from one office to another in order to obtain a permit. The number and intricacy of procedures vary from one city council to another. The over-complexity of paperwork prevents an equal economic and social development and increases the number of non-certified enterprises providing jobs that are unstable and of bad quality.

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<sup>54</sup> The institutions that participated in the debate of this proposal are: the Ministry of the Economy, SERCOTEC, the Ministry of Labour, the Ministry of Health, CONAMA, Fiscalía Nacional Económica, SERNAM, INDAP, SESMA, Asociación Nacional de Municipios, FOSIS, CORFO, SENCE, Banco del Estado, PROCHILE, Comisión PYMES, Cámara de Diputados, Confederación del Comercio Detallista, CONUPIA, Confederación de Dueños de Camiones, ASEXMA, Federación Metalmeccánica, OIT, CEPAL and Instituto Libertad, Corporación Justicia y Democracia.

**Table 4.2. Paperwork for City Council permits: Selected indicators, 2000**

	Economic activity of the enterprise		
	Commercial	Industrial	Professional
Number of licenses (average)	35.6	4.0	6.7
Cost (average) in US\$	68	752	22
Number of days required to obtain a license (time cost)			
Average	17.3	26.3	4.4
Maximum	175	208	39
Programme goal	7	7	7
Number of documents required by the City Council			
Average	5.0	5.7	3.0
Maximum	28	15	9
Programme goal	6	6	1
Number of forms filled in by the entrepreneur			
Average	1.7	1.8	1.3
Maximum	10	8	6
Programme goal	1	1	1
Number of trips from one office to another			
Average	3.1	3.3	2.1
Maximum	8	10	6
Programme goal	2	2	1

Note: Average and minimum correspond to City Council data. Source: Ministry of the Economy, 2001

The Ministry survey also evaluated resource availability, encouraging the simplification of official procedures. According to the survey, ICTs (Information and Communication Technologies) have already been implemented in almost 90 per cent of city councils, 46 per cent of which have at least one computer connected to a network. Nevertheless, 55 per cent of city councils have only one computer for processing permits. In almost 50 per cent of city councils, one person from the “Income Department” (*Departamento de Rentas*) performs the tasks related to the approval of permits, working together with one or two civil employees from the City Council Construction Office (DOM).

In this context, one of the “good practices” is the “Simplification of Paperwork Programme”, which was implemented in 2000 by SERCOTEC in the context of the Twelve Commitments of the President to the MSE Sector. This programme is aimed at diminishing the difficulties associated with the acquisition of local permits. Although the programme benefits all types of businesses, it is expected that MSEs will take more advantage of it, since the difficulties of obtaining a permit are more costly for smaller businesses. The operational objectives of the programme are reducing the time of official procedures to one week and diminishing the number of documents to six for industries and commerce and to one for professionals. Moreover, the programme seeks to define the type of documents required for each economic sector. Nowadays, learning how many and what type of documents are required is costly and time-consuming. The goal of the programme is to reduce the number of forms to one for all economic sectors and reduce the number of visits required to two.

In order to do so, the public sector (through SERCOTEC) has hired private consultants to incorporate new management techniques aimed at accelerating the approval of permits and reducing the number of procedures. In general the programme is simple and does not require too many resources. Often, the first task is to create awareness of the contribution that each civil servant makes in speeding up or slowing down license approval, for example. Key interviewees state that civil servants in the same office do not know what their colleagues are doing. Often, a document is lost when passing it from one desk to another, delaying the whole process. The solution is as simple as organizing each person's obligations in and among offices.

Table 4.3 shows that 59.3 per cent of micro-enterprises have initiated activities at the Internal Revenue Service: 39.6 per cent comply with regulations on health and hygiene, 34 per cent fulfill quality requirements and 31.7 per cent comply with working conditions. These requirements are prerequisites to obtaining a city council permit. Reducing the costs of compliance helps workers to monitor their working conditions. Registered businesses have access to public institutions such as the Labour Direction, which looks after job quality and supervises the legal obligations established by the Labour Code.

**Table 4.3. Micro-enterprises complying with tax payment and license requirements, 1996**

	Economic activity of the micro-enterprise		Total
	Industry	Commerce	
Firms complying with legal requirements (% of enterprises in each category <sup>a</sup> )			
Initiating operations	77.1	41.0	59.3
Regulations on			
Hygiene	26.2	49.3	37.6
Quality	20.5	47.8	34.0
Working conditions	36.7	46.8	41.7
Paying income tax and other levies	69.5	34.1	52.0
Paying VAT	72.4	41.0	56.9

Note: <sup>a</sup> The sample includes 415 micro-enterprises in the industry and commerce sectors.  
Source: Wormald and Rozas, 1996.

The pilot programme was implemented in 1997 in four city councils and achieved a considerable reduction in the time taken to obtain a license. The first stage of the programme in 1998 comprised seventeen city councils. In practice, in the first phase, the programme created an inter-departmental communication system within city councils, disseminated the use of ICTs, reduced the number of documents demanded of the entrepreneur (in 71 per cent of cases), reduced the number of staff involved in the approval of licenses (71 per cent of cases) and the number of visits from one public office to another for official procedures (in 53 per cent of cases). In the second stage of the programme (1999), 22 city councils were included in the programme. The results were similar. The third stage of the programme included 40 more city councils. The final objective was that by December 2001 over 100 city councils would have participated in the programme and its underlying rationale of fostering productivity and facilitating the creation of a strong entrepreneurial sector.

## 5. Conclusions

In the mid-1970s, the liberalization and reorientation of the Chilean economy towards external markets shaped an environment in which medium and large enterprises accounted for one-third of total employment, the largest share of value-added and almost all exports. By the 1990s, micro and small enterprises (MSEs) was a large, dispersed and less competitive sector than the medium and large enterprises. Rapid economic growth in Chile up to 1998 and the macroeconomic policies adopted since 1973 had favoured those medium and large enterprises that had access to external capital markets. The State was increasingly aiming to optimize the allocation of resources by becoming a “second-floor” actor – i.e. diminishing its direct involvement in productive activities. Compared with medium and large enterprises, the MSEs were disadvantaged by higher and more variable interest rates. During the 1990s, the share of MSEs in total non-agricultural employment diminished slightly. Moreover, a cyclical pattern can be observed: the employment share of MSEs tends to diminish in years of rapid economic growth and to increase in slow-growth years.

Quality of employment in MSEs is lower than in medium and large enterprises. Three types of indicator have been selected in order to evaluate the quality of jobs: compulsory benefits, non-compulsory benefits and working hours/remuneration. In all three areas, the smaller the firm, the poorer the quality of jobs. For compulsory benefits, the CASEN Survey reveals a comparatively high level of compliance with regulations, although compliance is lower in MSEs. In 2000, for example, 61.2 per cent of salaried MSE workers had received written contracts, compared to 90.9 per cent of workers in medium and large enterprises. For voluntary benefits, the situation was still more revealing. Here again, the smaller the firm, the lower the benefits provided. For example, only 8 per cent of MSE workers had access to training compared with 30.4 per cent of workers in medium and large enterprises in 2000. While hours worked are roughly the same for all enterprises, remuneration tends to be lower in MSEs. Similarly, MSEs comprise comparatively more workers under the poverty line than medium and large enterprises.

With the exception of health insurance and poverty levels, all indicators tended to deteriorate even during the growth period. Economic dynamism was not mirrored by an improvement of job quality in MSEs or in larger enterprises. During the economic crisis, indicators of job quality showed expected variations, when recession further deteriorated all indicators.

Gradually, the policy environment became more receptive to MSE needs. In the beginning of the 1990s, the newly established democratic government decided to reinforce less advantaged sectors. By boosting social dialogue, the government sought to create a positive climate for “Economic Growth with Equity”. This slogan strengthened all public initiatives implemented during the decade. The first effort to boost dialogue was a tripartite National Agreement in 1990. In 1991, a National Plan in support of small and medium enterprises was enacted. Both initiatives were a public attempt to promote the economic development of less advantaged sectors and mainly focused on micro, small and medium enterprises (MSMEs). These initiatives involved the participation of all actors: government, employers and employees. Until 1998, various social dialogue bodies such as the tripartite Economic Development Forum (Foro para el Desarrollo Económico) were implemented in order to strengthen the voice of all actors. At the same time, the Government was modernizing

those facilities aimed at boosting competitiveness in MSMEs. On balance, however, the Government favoured economic goals over social ones. This may have prevented the re-establishment of a tripartite social model in which all actors are able to influence the decision-making process to defend their particular (and often conflicting) interests. A second contributing factor is the lack of coordination among government offices, which frequently prevents public facilities from being effective.

In 1998, the economic crisis in Chile severely hit those businesses that were highly indebted. Until then, both micro and small enterprises had enjoyed a significant supply of financial resources which had been mediated by the Government. Several financing programmes (the FOGAPE guarantee funding and the CORFO credit lines, for example) aimed to broaden MSE access to financial support. However, interest rates and conditions of access to credit were set by the private financing sector which provided credit at higher and more variable rates to MSEs, while the less risk-prone large enterprises enjoyed lower and more stable interest rates. When the crisis hit, indebted MSEs faced a sudden debt increase. At the same time, interest rates were raised to keep inflation down. In addition, the tripartite Economic Development Forum had achieved poor results in fostering social dialogue, causing the private sector to mistrust public initiatives. These factors encouraged the Government to reinvigorate public discourse on MSE-related issues.

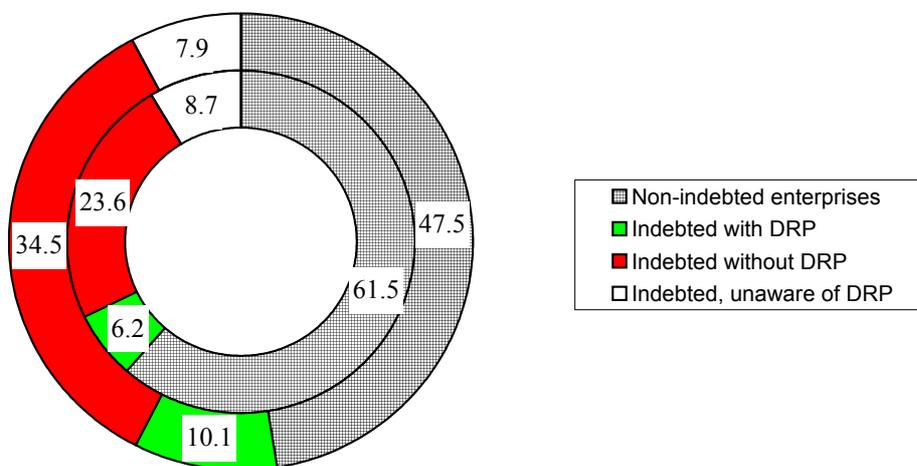
In 1999, the Government published the “Twelve Commitments of the President to the MSE Sector”. The Public-Private Committee (PPC) was established to boost social dialogue in MSME-related issues and to follow up on these commitments. The PPC is a bipartite dialogue body that does not include workers (because of the low number of trade unions in MSMEs). Nevertheless, it did identify and act on some weaknesses in the MSME sector. For example, the PPC discussion on whether or not a non-differentiated regulation framework<sup>55</sup> would impede the performance of less advantaged enterprises resulted in the Legal Statute for MSMEs.

The economic crisis has justified the implementation of various public programmes other than the PPC. The Debt Renegotiation Programme (DRP), for example, has been one of the main initiatives aimed at alleviating the financial setbacks confronting highly indebted MSEs. The renegotiation of debts (including those associated with social security payments) is in workers’ interests although the number of firms renegotiating this type of debt is comparatively low. Within enterprises surveyed, Figure 5.1 shows that while indebted firms represented 48.5 per cent of micro-enterprises and 62.5 per cent of small enterprises, only 6.2 per cent of micro-enterprises and 10.1 per cent of small enterprises accessed the DRP in 2001. Some firms remained unaware of this programme’s existence (8.7 per cent of micro and 7.9 per cent of small enterprises). Of those indebted micro-enterprises that created jobs from 1999 to 2001, 33 per cent used the DRP. A total of 12 per cent of the indebted micro-enterprises that either retained or reduced jobs used the programme. The DRP may thus have facilitated employment creation in indebted MSEs.

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<sup>55</sup> The Chilean regulatory framework is fairly undifferentiated for all kinds of enterprises, regardless of their size.

**Figure 5.1. Debt Renegotiation Programme for MSEs, 2001 (percentage)**



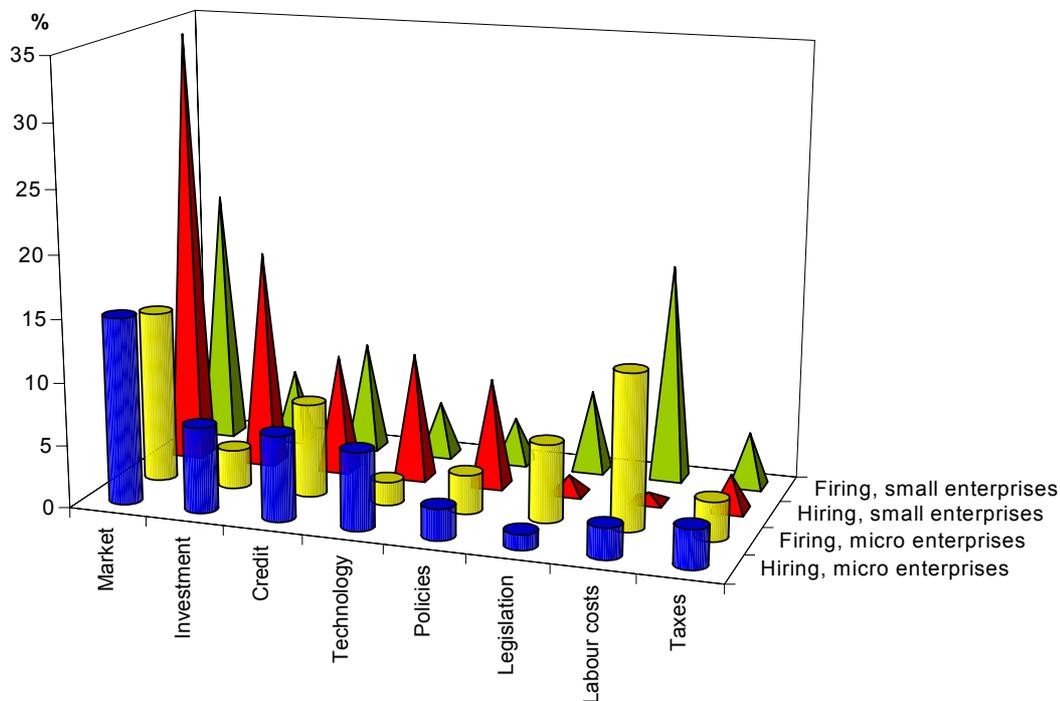
Note: The inner circle represents micro-enterprises, the outer circle small enterprises.

Source: ILO MSE Survey 2001.

Survey evidence demonstrates that when deciding to hire or fire workers, MSE employers are influenced more by their own position in the economic environment (market, investment, credit) than by the policy and regulatory environment (support policies, labour costs, legislation or taxes). Figure 5.2 shows that the institutional framework is not particularly favourable to the creation of employment in MSEs. Moreover, public facilities such as the National Training Service and the programmes for promoting productivity (such as PROFO) tend to have an indirect effect (if any) on job quality in MSEs.

In this respect, one of the elements in the policy environment might directly favour the employment pattern in MSEs. This is the mounting public interest in introducing the MSE sector into the framework of market-led development strategy. Boosting the PROFO programmes and encouraging proactive attitudes would reinforce the ability of MSEs to adapt to a system where the provision of public facilities is delegated to the private sector through a demand subsidy. Thus it is critical that the MSE sector is able to access those private organizations providing public facilities under government supervision and subsidy in education, health and social security. One example is training. MSEs under-use training facilities because they are not adapted to their specific needs and because the micro and small entrepreneurs do not form a cohesive group to voice their training needs.

Figure 5.2. Main factors in employment decisions in MSEs, 2001



Source: ILO MSE Survey 2001.

The aim of reinforcing the private sector does not include workers' organizations: the present Labour Code prevents the creation of trade unions in micro-enterprises. As in most countries, MSE workers in Chile are weakly organized and cannot bargain collectively to obtain improvements in working conditions and thus the productivity that would lead to better jobs. To date, there have been no initiatives promoting workers' organizations. The technical support agency SERCOTEC has organized citizenship surveys in order to collect opinions from workers and non-organized entrepreneurs. Here, the last labour reform seems to have improved this issue, even though workers in all smaller firms are still unable to create trade unions.

Programme implementation is hampered by one major obstacle identified above: the lack of coordination among government agencies. This problem is rooted in both the complicated regulatory framework and the modernization of the State, which has implied the delegation of power. Thus, independent offices are implementing activities with no direct supervision by a centralized office. For example, the discussion of the Legal Statute for MSMEs, mentioned earlier, was spearheaded by the Ministry of the Economy through its participation in the Public-Private Committee. In April 2001 the Ministry of the Economy presented a proposal (discussed in this research) which was not approved by the rest of the Committee. At the same time, SERCOTEC created a commission to discuss the Statute. For four months, both the Ministry of the Economy and SERCOTEC were working separately on the proposal, with no contact between them. In September 2001 a joint commission was

appointed to draft a new proposal. Such duplication of effort is hampering rapid and concrete solutions, adding to task loads and wasting resources.

Another striking example of the lack of coordination among government agencies is the difficulties of obtaining a license. Although the registration process is aimed at protecting and generating a favourable environment for economic development, many firms cannot afford licensing costs and remain unregistered. Lack of institutional coordination is complicating the licensing process unnecessarily and may also be creating incentives for businesses to remain unregistered.

During the first phase of democratic government, CORFO was appointed to coordinate all programmes and projects aimed at boosting MSMEs. This attempt to centralize the public management of MSME facilities has successfully diminished coordination problems in most programmes aimed at boosting productivity. However, centralizing MSME issues in one public office has meant that poverty-alleviating policies are now located in another public office (FOSIS). But as micro-enterprises present a higher level of poverty, they are institutionally perceived as requiring social rather than productivity programmes. This effectively precludes the FOSIS-targeted segment from participating in CORFO programmes.

In sum, although the policy environment for MSEs in Chile is relatively transparent, the several biases against MSEs outlined above are obstacles to increasing productivity and creating better jobs in the MSE sector.



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## **Annex 1. Sources for data analysis**

**CASEN Survey:** A household survey which comprises a representative sample of the total population. Since 1987, the Ministry of Planning has carried out the survey together with ECLAC and the University of Chile. So far, the survey has been implemented 7 times (in 1987, 1990, 1992, 1994, 1996, 1998 and 2000) providing information about housing, health, education, employment, income and poverty among other variables. The survey includes comprehensive data both on employment by enterprise size classes and job quality. Unfortunately, a change in the design of the questionnaire between 1996 and 1998 makes the distribution of employment by size classes inconsistent over time.

**Employment Survey:** A household survey which gathers a representative sample of the total population. It is run by the National Statistical Institute (INE) and contains employment data. The document uses information of the last trimesters of the years 1990 to 2002. From 1992 onwards, the survey includes data on employment by enterprise size class. However, the size classes used (1–4 workers, 5–9 workers, 10 or more workers) only allow the measurement of micro-enterprise employment, without any distinction between small, medium-sized and large enterprises.

**Remuneration Survey:** A business survey which classifies information of a representative sample of the total registered businesses. It is conducted by the National Statistical Institute (INE) and contains information about wages and labour costs. The document uses information of trimesters of 1990, 1996, 1998, 1999 and 2000.

**Micro-Enterprise Survey:** An *ad-hoc* survey, conducted by the Ministry of Planning (MIDEPLAN) in 1999. The survey contains business information about self-employment, micro-enterprises (with less than 10 employees), employment, production and input costs.

**ENIA – INE:** An establishment survey covering a representative sample of registered manufacturing enterprises with 10 or more employees. It is run by the National Statistical Institute (INE) and contains information about employment, production and input costs.

**SII:** A business data base run by the Internal Revenue Service (SII) and the National Statistical Institute (INE), containing data from all businesses which pay taxes in First Category (see policy mapping). The data base contains data about production and is available for the period 1994–1999.

**ILO MSE Survey, 2001:** An enterprise level survey commissioned by the ILO, comprising 300 MSEs from rural and urban zones in the V, VI and XIII Regions.

The definition of micro and small businesses varies according to the source of information. An employment-based definition is used for the analysis of the CASEN, Employment (INE), Micro-enterprise and MSE Surveys. This definition classifies micro-enterprises as businesses with one to nine workers and small businesses as businesses with 10 to 49 workers. Within the data for micro-enterprises, the information for the self-employed and one-person businesses is presented separately. The ILO MSE Survey only includes enterprises with 2 or more workers.

The official definition for administrative purposes is based on annual turnovers (ENIA and SII surveys). The definition by size of turnover characterizes micro-enterprises as businesses with an annual turnover under UF2,400, whereas small businesses are defined as those having an annual turnover between UF2,401 and UF25,000 (UF = US\$25 approximately).



## Annex 2. Institutional framework

	Original Name	Name in English	Status
AFP	Administradora de Fondos de Pensiones	Pension Fund Administrator	Private
ASEXMA	Asociación de Exportadores de Manufactura	Manufacturing Exporters Association	Private
ASIMET	Asociación de Industrias Metalúrgicas y Metalmeccánicas	Association of Metallurgic and Metalworking Industries	Private
Banco del Estado	Banco del Estado	State Bank	Public, subject to the Ministry of Finance
CENAPRO	Centro Nacional de la Productividad	National Center of Productivity	Mixed
CEPRI	Centro de Productividad Integral	Center for Integral Productivity	Private
CNPC	Centro Nacional para la Productividad y la Calidad	National Center for Quality and Productivity	Mixed
CONAMA	Comisión Nacional del Medio Ambiente	National Commission for the Environment	Public and decentralized
CONAPYME	Confederación Nacional para la Pequeña y Mediana Empresa	National Confederation of SMEs.	Private
Confederación Chilena del Comercio Detallista	Confederación chilena del comercio detallista	Chilean Confederation of Retail Commerce	Private
Confederación de Dueños de Camiones	Confederación de Dueños de Camiones	Truck Owners Confederation	Private
CONUPIA	Confederación Nacional Unida de Mediana, Pequeña y Micro Industria, Servicios y Artesanado	National Confederation of MSMEs in the Industry, Services and Craftsmen	Private
CORFO	Corporación de Fomento	Corporation of Productivity Promotion	Public Decentralized Agency of the Ministry of Economy
CPC	Confederación de la Producción y el Comercio	Production and Commerce Confederation	Private
CUT	Central Única de Trabajadores	National Workers Union	Private
DOM	Dirección de Obras Municipales	City Council Construction Office	Public
ENAMI	Empresa Nacional de Minería	National Mining Enterprise	SOE
ENAPE	Encuentro Nacional de la Pequeña Empresa	National Meeting of Small Enterprises	Mixed
FAT	Fondo de Asistencia Técnica	Technical Assistance Fund	Public, operated by CORFO

	<b>Original Name</b>	<b>Name in English</b>	<b>Status</b>
FDI	Fondo de Desarrollo e Innovación	Innovation and Development Fund	
FOGAPE	Fondo de Garantía para la Pequeña Empresa	SME Guarantee Fund	Public, operated by the State Bank
FONASA	Fondo Nacional de Salud	National Health Fund (public health insurance)	Public, subject to the Ministry of Health
FONCAP	Fondo Nacional de Capacitación	National Fund for Employee Training	
FONTEC	Fondo Nacional de Innovación Tecnológica y Productiva	National Fund for Technological and Productive Innovation	Public, administered by CORFO
FONTEC	Fondo de Innovación Tecnológica	Fund for Technological Innovation	Public
FOSIS	Fondo de Solidaridad e Inversión Social	Solidarity and Social Investment Fund	Ministry of Planning, decentralized agency
GTZ	Deutsche Gesellschaft für Technische Zusammenarbeit	German Chamber of Technical Cooperation	Foreign (Germany)
INACAP	Instituto Nacional de Capacitación	National Training Institute	Mixed
INE	Instituto Nacional de Estadísticas	National Statistical Institute	Public
ISAPRE	Instituto de Salud Provisional	Private Health Insurance	Private
MIDEPLAN	Ministerio de Planificación	Ministry of Planning	Public
MINECON	Ministerio de Economía	Ministry of the Economy	Public
OID	Organizaciones Intermediaras de Desarrollo	Intermediary Development Organizations	Mixed
OTIC	Organismos Técnicos Intermedios de Capacitación	Authorized Training Organizations	Private
PDF	Foro de Desarrollo Productivo	Productive Development Forum	Mixed
PPC	Comité Público-Privado para la Pequeña Empresa	Private Public Committee for Small Businesses	Mixed
PRO CHILE	Dirección de Promoción de Exportaciones	Export Promotion Office	Public, subject to the Ministry of Foreign Affairs
PROFOS	Programa de Fomento	Development Programme	Public, operated by CORFO
PROPESA	Corporación de Promoción para la Pequeña Empresa	Small Enterprise Development Corporation	
PROPYME	Programa de Promoción de la Exportación	Chilean SME Development Program (for the Development of Exports)	Mixed, Government Project, developed by Chile and Germany
Registro Civil	Registro Civil	Civil Registry	Public

	<b>Original Name</b>	<b>Name in English</b>	<b>Status</b>
SENCE	Servicio Nacional de Capacitación y Empleo	National Service of Training and Employment	Public
SERCOTEC	Servicio de Cooperación Técnica	Technical Support Service	CORFO Agency
SESMA	Servicio Metropolitano de la Salud Ambiental	Metropolitan Environmental Health Service (Part of the National System of Health Services)	Public, decentralized, autonomous
SII	Servicio de Impuestos Internos	Internal Revenue Service	Public, subject to the Treasury Ministry
SOFOFA	Sociedad de Fomento Fabril	Manufacturing Development Society	Private
SSA	Servicio de Salud del Ambiente	Environmental Health Service	Public, decentralized
SUBDERE	Subsecretaría de Desarrollo Regional	Regional Development Undersecretary's Office	Public, subject to the Ministry of Internal Affairs
Superintendencia de Electricidad y Combustibles	Superintendencia de Electricidad y Combustibles	Electricity and Fuel Superintendence	Public



### **Annex 3. List of key interviewees**

*(For acronyms, refer to Annex 2)*

#### **Public sector**

Jaime Ruiz Tagle: MIDEPLAN  
Gonzalo Rivas: Assistant Director, CORFO  
Lucía Alfaro: SERCOTEC  
Loreto Aceitón: SERCOTEC  
Tomás Bize: SERCOTEC  
Romualdo Hernández: SERCOTEC  
Rodrigo Cárcamo: PROCHILE  
Regina Rodríguez: PROCHILE  
Carlos Ríos: Ministry of Economy  
Carlos Díaz: MINECON  
Álvaro Díaz: Assistant Secretary MINECON

#### **Private sector**

Patricia Díaz: Club Mujer (Microentrepreneur Women Association)  
Microempresarios: Steven Cohn,  
Germán Dastres: CONUPIA  
Haydee Moreno: CONUPIA  
Enrique Román: Assistant Director CEPRI  
Osvaldo Muñoz, Flacso

#### **Others**

Osvaldo Shenke: consultant PYME  
Carlos Barrenechea: consultant PYME  
Guillermo Pérez: OIT  
Winston Elphig: OTIC



## Annex 4. Impact assessment of PROFO

This research evaluates the impact of PROFO (Fostering Programmes) in the productivity of businesses. The evaluation generates qualitative and quantitative results. Data comes from two sources: the National Manufacturing Survey (ENIA-INE) and a special survey from the Economy Department of University of Chile (Álvarez, Benavente, Crespi, 2000). The quantitative methodology used to evaluate the impact of the programme is called the experimental method. This procedure involves the identification of two sample groups where each observation (business) has a “comparative business”. One of the businesses represents the case “with PROFO”, the other one represents the case “without PROFO”. The group of businesses “with PROFO” is formed by one hundred and two businesses studied in detail by the Department of Economics of the University of Chile. Their “comparative businesses” are carefully selected by the ENIA Survey. This procedure requires information before and after the project because what we want to estimate is the “differences on differences” indicator ( $\alpha$ ).

$$\alpha = (\bar{Y}_{1t} - \bar{Y}_{1t-1}) - (\bar{Y}_{0t} - \bar{Y}_{0t-1})$$

Where:

$(\bar{Y}_{0t} - \bar{Y}_{0t-1})$  : Average productivity growth from period t-1 (before PROFO) to period t (after PROFO) in non-participating businesses (subscript 0).

$(\bar{Y}_{1t} - \bar{Y}_{1t-1})$  : Average productivity growth from period t-1 (before PROFO) to period t (after PROFO) in participating businesses (subscript 1).

This procedure allows to control the productivity variations from external elements non-related with the PROFO, affecting both the “with PROFO” and “without PROFO” business.

Nevertheless, this particular exercise shows some problems in the selection of the samples. Since participation in the PROFO is “voluntary” it is likely that all businesses in the “with PROFO” segment share a particular characteristic that businesses in the “without PROFO” segment do not share. It has also been demonstrated that labour productivity is significantly higher among participating businesses than among non-participating businesses before the PROFO (period t-1).



## **Annex 5. The Legal Statute for micro, small and medium enterprises**

The Legal Statute for micro, small and medium enterprises (MSMEs) was introduced in April 2001 and is aimed at developing a group of definitions in order to institutionalize policies to foster the SME sector. According to the proposal, the productive development of MSMEs requires a network of supportive devices to create a platform determining the basic regulation principles in order to stimulate MSME economic participation.

### **The Legal Statute's administration**

For policy design purposes, authorities in charge are a group of ministers coordinated by the Minister of the Economy. This group must delegate the execution of the programmes to a group of selected institutions. The Ministry of the Economy must monitor the functioning of the markets and suggest relevant corrections for the normal development of MSEs. The Ministry of the Economy will annually account for the state-of-the-art in the development of the sector. Policy-making will be done together with the PPC. The PPC must inform about programmes available and choose private suggestions and initiatives. Besides, in order to accomplish the SME development goal, other public institutions must advise them on the following topics: market features and operation, official procedures to certify the business guide, public programme availability, corporation cohesion, long-term financial tools, technological transfer and innovation, technical assistance and training.

The Legal Statute establishes the creation of the National Commission for the SME (CONAPE) to analyse the situation of SMEs and the impact of policies and laws implemented. Six representatives named by the President of the Republic will head this commission, three of whom will be from the public sector. The other three representatives will be from the private sector (business associations). Together with the Ministry of the Economy, CONAPE would account every year for the state-of-the-art in the activities related to the sector's development, including future perspectives and a regional analysis. CONAPE would be expected to support the Ministry to reach its goals related to SMEs.

The Corporation of Productivity Promotion (CORFO) would take a second floor role in all the programmes involving guarantees, subsidies, subventions, financial credits, etc. The idea is to centralize in CORFO all financing activities now distributed among several public institutions representing each economic sector (INDAP in agriculture, ENAMI in mining, IFOP, CONAF, FOSIS, etc. see Annex 1). Each institution's budget should be agreed upon depending on the programme and devices administrated and coordinated by CORFO, through the "Financing Assistance System for MSMEs". This system would include all financing devices in operation. The statute contemplates the creation of a law in order to pass the administration of all present financing programmes to CORFO (for instance, FOGAPE, now coordinated by the Bank of the State). However, each authority would keep the decision-making power regarding issues related to priorities of their sector, and the obligation to evaluate and justify programmes related to the sector. The relationship between each sector service and CORFO, and the proposals of each one of the parties, would be observed and evaluated by CONAPE. CONAPE would give advice in terms of the design and implementation of financing devices and watch for the accomplishment of the goals established by CORFO for each of the programmes. CONAPE would also evaluate the programme impact.

The central authority (through CORFO) would always act as a "second-floor" agent, since their obligations are the design, dissemination, implementation and application of programmes, while the private sector, responsible for financing, would channel the resources to MSMEs. In the future, CORFO would design and make proposals for mechanisms to motivate the private sector to cooperate

in financing. The idea is to build a strong financing private sector through the implementation of public programmes. CORFO would also be in charge of fostering and supporting the cooperative system of savings and credits.

CONAPE is expected to coordinate the programmes currently administrated by the Bank of the State in order to boost coordination of the financing system, i.e. between the Bank of the State and CORFO. This commission must evaluate and monitor the initiatives of other public offices (SUBDERE, local authorities, etc.) in order to build a risk-capital industry. The Intendancy of Values and Insurance (SSV) must develop the stock market in the sector.

### **Public budget**

The Legal Statute states that public budget must include funds in order to finance programmes to develop the MSE sector and supporting institutions, particularly those related to technical assistance, technological transfer, innovation in production and management areas, training, information availability, productive chains and geographical “clusters” enhancement, export promotion, corporation cohesion and association promotion, implementation of non-financial programmes, accomplishment of sector authority goals and impact evaluation of programmes.

### **Delegation of powers: public versus private suppliers**

The Legal Statute states that local authorities must be motivated to participate in official instances of production promotion. The goal is to create a web page (“*ventanilla única*” [www.tramitefacil.cl](http://www.tramitefacil.cl)), aimed at diminishing the costs of compliance and generating a favourable environment for MSME production development. Thus, the Statute encourages local authorities to work efficiently on a regular basis. However, the Statute does not propose any concrete instance of participation. It does not consider the coordination of these instances with the functions of other public agencies either.

It is also stated that corporation cohesion must be enhanced in order to spread the knowledge of public programmes. This Statute establishes that corporation associations must manage the programmes. It says nothing about the means which will financially support these associations, though.

The Legal Statute is very ambiguous with respect to the coordination of the public sector. It suggests that the Vice Ministry of the Economy (historically in charge of administrative matters in the Ministry of the Economy) must be the coordinator of all public actions to foster productivity in MSMEs. The problem is that the Statute gives decision-making power to the Vice Ministry for the coordination of the initiatives of several public institutions which are more powerful and have more fiscal resources. Moreover, the Statute assumes that these public institutions would keep their decision-making power. Therefore, the Statute does not account for the fact that the coordination problems are due to the overlapping of decision-making powers.

According to the Statute, PROCHILE and CORFO (see Annex 1) are the guardians of the new Export Promotion Fund in order to boost non-traditional exports. They are also in charge of preventing the excess of centralization, by attracting capital of MSMEs to regions. However, these objectives are already part of the description of tasks of these institutions. The Statute lacks operational objectives; it is therefore very likely for the impact to be very low regarding this matter.

The Statute considers only tangentially the promotion of the private sector as a supplier of public programmes (training and productivity promotion). Private executors are a key element in the implementation of programmes, and also of policies to improve MSMEs. However, they have not been reckoned in the Statute as public institutions have, neither in terms of promotion nor in terms of their responsibilities. The Statute also states as a policy objective that monopolistic behaviours must be avoided. However, it has not been reported whether this objective refers to the scarce competitiveness

of MSMEs or to the insufficient development of private suppliers of public programmes. Regarding this aspect, SERCOTEC competes as a public office – sponsored by the State – with private suppliers. It is argued that privately provided public programmes are less expensive than those provided by SERCOTEC. The Statute does not consider this contradiction.

### **The regional perspective**

The Legal Statute states that the State must boost R&D for the development of MSMEs. Local authorities should create links between the academic arena and businesses by leading the former to develop issues (through teaching, research, technical assistance, and internships in MSMEs). It neither includes operational objectives nor does it make proposals regarding ways to reach the goals.

The Regional Resources Allocation Committees are proposed by the Statute as the main public institutions to foster productivity and coordinate public initiatives. Nevertheless, the Statute does not consider that in order to be effective, these committees should have decision-making power regarding the use of resources of institutions which manage public initiatives. For now, that degree of decentralization is still too much for the Chilean model.

In conclusion, it is argued that the Legal Statute lacks of applicability, because an extremely centralized system often hinders the functioning of most proposals. Moreover, the failure of the Statute might probably generate conflicts among public institutions.

The Statute suggests new types of societies: the “Production and commerce society” and the “Individual business of limited responsibility”. The first one is easier to constitute and responds to the characteristics of an MSME. The second one protects the entrepreneur from losing his or her private assets in case of bankruptcy.

### **Other issues**

Regarding labour security, the Legal Statute suggests extending the benefit of labour accidents to entrepreneurs. However, the Chilean Safety Association (ACHS, see Annex 1) had planned the initiative before. The real problem with labour security is that fees are directly related to the percentage of accidents in the business. If one accident occurs in a MSME, the business is automatically classified as very risky, because one injured worker among a few non-injured workers creates a high rate of accidents. Therefore, the fees would be relatively high for smaller businesses (with fewer workers). The Statute does not mention this issue, though.

The Legal Statute promotes a code by which buyers will not be able to use fiscal credit until they have actually paid the supplier for the inputs and the associated VAT. This would stop current practices where large businesses obtain immediate credits (fiscal credit) given by small suppliers<sup>56</sup>. The Statute does not describe how this objective is going to be accomplished, because this practice would diminish fiscal revenues.

The Statute also seeks to improve the probability of MSMEs of being suppliers of the public sector by forcing the publication of technical requirements in order to obtain a license to do so. All public offices must recheck these technical conditions in order to suppress discrimination against MSMEs. Regarding this matter, the Statute suggests eliminating the tariff suspension for the imports of military equipment, especially the import of clothes and shoes by the Army. The elimination of this tariff goes against domestic producers of clothes and shoes, because the importation of goods becomes cheaper than purchasing domestic goods.

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<sup>56</sup> Small enterprises are asked to submit a bill to private and public large buyers, before they obtain the payment; so they are forced to pay the VAT related to these bills even if they obtain the payment 120 days after the purchase has been made.

In sum, the Statute seems to be a big step in terms of “putting the MSME issue on the table” and a good exercise in order to detect the elements that prevent MSMEs from having equal opportunities for economic development. However there has often been disagreement regarding the modernization of public policies and public administration implemented so far. The Legal Statute for MSMEs is a proposal clearly directed towards the reinforcement of the State over private suppliers. To avoid failures, the Statute needs revision in order to make objectives operational and to propose concrete ways of implementing the propositions. It certainly requires feedback from the private sector (private suppliers rather than entrepreneurs) and from the worker sector, since the Statute supports productivity, but says nothing about generating decent jobs.

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