Losing Ground in the Employment Challenge

The Case of Paraguay

Albert Berry

and Contributors

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Contents

Illustrations vii
List of Contributors ix
Acknowledgments xiii
Introduction Albert Berry 1
1 Elements of an Employment Strategy for Paraguay Albert Berry 11
2 Labor Market Functioning in Paraguay Guillermo García-Huidobro 41
3 The Role of Agriculture Albert Berry 61
4 Farm Size-Productivity Relationships in Paraguay’s Agricultural Sector Ricardo Toledo 85
5 Potential and Future of Paraguayan Family Farming Luis A. Galeano 101
6 Industry and MSMEs in Paraguay: Their Potential for the Creation of Remunerative Employment Albert Berry 123
7 Patterns of Productivity Enhancement in Small and Medium Enterprises: “Higher-Order” Upgrading Nichola Lowe 143
8 Growth and Technological Modernization Jorge Katz, Melissa Birch, and Ninia Torres 163
Patterns of Productivity Enhancement in Small and Medium Enterprises: “Higher-Order” Upgrading

Nichola Lowe

Introduction

As discussed in the previous chapter, a key challenge for job-creating growth in Paraguay is an adequate rate of technological advance in the small and medium enterprise sector so that overall factor productivity rises significantly over time. This chapter draws on interviews with the owners and/or general managers of approximately 25 small and medium enterprises that have responded to new economic challenges by embracing strategies for higher-order technological upgrading, i.e., upgrading in ways that involve progressive labor policies. The experiences of these enterprises provide insights into mechanisms that can hopefully be generalized to a wider range of Paraguayan firms.

“Upgrading” refers to one or more types of improvements to traditional firm practice or routine, including:

i) Market upgrading—efforts to broaden market reach and/or gain access to quality-conscious niche markets, domestic or international;

ii) Functional upgrading—the expansion of a firm’s existing repertoire of skills (Humphrey and Schmitz, 2000), as when commercial establishments integrate backwards into manufacturing or traditional subcontractors, or when “bare bones” assemblers develop new skills in product design, product development and testing (and thus, quality control) and/or direct marketing;
iii) **Process upgrading**—improvements within existing skills or activities;

iv) **Network upgrading**—as where firms invest in supply chain management and coordination by improving relations with upstream suppliers and/or downstream customers, or develop intra-sectoral alliances involving firms that produce related goods and services or non-market actors and institutional supports that contribute to the sector’s growth.

The upgrading is termed **higher-order** when it is combined with positive labor practices in which firms value and reward their employees’ contribution to the upgrading process. This commitment typically takes the form of progressive wage and benefit policy and on-going efforts to improve working conditions and labor relations such as vocational training and educational support for workers, and often additional educational and medical support for employees’ children and spouses with a view to eliminating some of the social and economic challenges that affect worker productivity and participation, and at the same time keeping open opportunities for inter-generational recruitment and hiring. Such firms view employees as part of the upgrading solution, rather than an obstacle to organizational change.

Our focus is on the adjustment process of Paraguayan firms and on the factors and elements of support that have enabled some of them to be successful in such upgrading even at a time of stagnation of the national economy and of volatility within the MERCOSUR region. While the majority of the firms on whose experiences we draw here employ less than 50 workers, two large (over 500 workers) firms have been included—one an apparel maker, the other a textile mill—because they provide crucial upgrading and mentoring support to existing SME operations in the country. As illustrated below, these firms also act as “anchor” operations for a sub-set of smaller firms engaged in network upgrading.

There is a general perception that, when attempting to respond to the many pressures and challenges of the last decade or so, Paraguayan firms do so by employing labor shedding and labor squeezing tactics. The cases highlighted here demonstrate that such is not always the case and, hopefully, that it need not be the general case. The same macro-economic challenges that are often said to encourage low-road survival strategies are also referenced by Paraguayan firms committed to higher-order upgrading. In the latter case, the national recession, financial sector crisis and unstable regional markets are said to **motivate** the search for an alternative growth path. What explains the variation in firm response? What lessons can policymakers take from the higher-order cases? It is argued here that these firms can have an important “demonstration” effect on other firms in Paraguay as well as being an important policy resource to stimulate additional rounds of upgrading by acting as industry mentors and policy advisors. The evidence on higher-order forms of upgrading also allows policy analysts to make recommendations that bolster, rather than breaking apart, existing institutional supports for creative forms of upgrading.

**Higher-Order Upgrading**

In this section, we present examples of higher-order upgrading in Paraguay, including information on firms’ employment practices, use of existing policy supports and incentive programs, and challenges or obstacles to growth.

**Market Upgrading**

One form of market upgrading in Paraguay has involved firms seeking access to export markets through the recently created (late 1990s) *maquiladora* program. As in the case of Mexico, *maquiladora* operations are exempt from most duties on imported goods that are assembled and re-exported and are eligible for additional tax-breaks and infrastructure assistance. MERCOSUR countries are providing additional support to the program and have granted special privileges to Paraguayan *maquiladora* operations in the form of relaxed regional content requirements—i.e., imported materials from outside the region that are assembled by Paraguayan *maquiladoras* for re-export are counted as regionally procured. The goal is to stimulate investment and job growth in MERCOSUR’s poorest country by giving export-oriented firms an added regional advantage. To be eligible for the program, investors are required to set up a bond as a guarantee of re-export and are also required to work with a foreign sponsor or “matriz” that agrees to act as an initial guarantor of export sales.

In contrast to the Mexican case, virtually all *maquiladora* operations in Paraguay—of which there were 17 at time of writing—are owned and operated by experienced Paraguayan entrepreneurs and businessmen. In most cases they are spin-offs from well-established Paraguayan firms that are using this program to diversify their market orientation and break into highly competitive export markets in North and South America. Mexico’s *maquiladoras* have historically been controlled and managed by foreign interests and have long been criticized for their
low local content ratios (an average of 2 percent of material inputs), high worker turnover, limited opportunities for career advancement, and minimal (and in some cases, negative) developmental impact for their host country (Lowe, 2005). In Paraguay, however, the initial participants in the program have not only remained connected to the local economy, but offer workers a source of stable employment. They have also created upgrading opportunities for other Paraguayan businesses by using their exchanges with foreign buyers to negotiate sourcing arrangements for their existing maquiladora suppliers, as in the case of apparel making, where maquiladora owners not only maintain close working relationships with domestically oriented manufacturing facilities (e.g., exchanging information and sharing services and skilled employees), but have helped national suppliers gain access to important transnational supply chains. Though this limited participation of foreign firms in Paraguay’s maquiladora program has been viewed as a sign of policy failure by some elected officials, we are more inclined to see its initial attractiveness to and use by well-established Paraguayan businessmen as a success, since it has resulted in investments by individuals that are not only embedded within the regional economy but committed to a broad set of national development goals. Efforts to recruit other Paraguayan business owners into the program have been difficult in recent years, partly because only a limited few have the financial resources to set up new manufacturing operations. In addressing this challenge it is important to learn from those firms already participating in the program, as well as from others that have given it serious consideration. Possibly the program’s official mandate can be amended to encourage investments that open up greater sourcing opportunities for Paraguayan-owned firms and supplier operations, especially those that are small- and medium-sized. The maquiladora program could be an important tool for easing informal sector firms into the formal sector, including firms historically affiliated with pirating activities, an option currently under study by those in charge of program promotion.

A common characteristic of firms involved in the maquiladora program is their commitment to market diversification, a strategy not limited just to export firms, but pursued also by firms that are domestic-market focused, especially those facing considerable competition from imported goods. While outward orientation does offer many benefits, including potential access to a larger customer base, export sales in and of themselves are no guarantee for sustained growth, as witness the impact of the Argentinean and Brazilian crises on Paraguayan export firms. Paraguay is a small economy located in a region that has, at least recently, suffered a high level of volatility. This combination of conditions puts a special premium on diversification of markets and on firm-level flexibility. The cases analyzed suggest that firm resilience to new and shifting market pressures—both within and outside Paraguay—comes from strategic planning, preparedness against future shocks (recent shocks are often the initial motivation for market diversification) and finally, reflexivity and specifically a willingness to learn and change (including making technology and process improvements).

In the process, many firms have been able to regain their competitive advantage by increasing their productivity, as well as by tailoring their products and services to the specific needs of their clients and customers (see below). These factors must be taken into account in the design of the SME support system. They suggest that future export assistance for SMEs should also be matched with equal forms of support to firms seeking to broaden their market reach within Paraguay, especially where import competition remains high. A dual approach such as this will not only help in the development of formal markets at home but, more importantly, can provide an additional social benefit in so far as it can be used to encourage inward looking firms to create a line of affordable, quality products for poor and working families in Paraguay. Support for firm upgrading can thus be used to address a larger set of poverty-related concerns, including food insecurity and malnutrition.

Paraguay’s first maquiladora operation, Alfesa, was created in 2001 as a quasi-independent export arm of apparel giant, Martel-Fénix, with the goal of diversifying into export markets, as well as stabilizing factory employment by assigning production lines to Alfesa. Although Alfesa directly employs only a half dozen or so employees, the production orders outsourced to Martel and three other Paraguayan manufacturing operations account for an additional 300 or so indirect jobs for the company. The company’s responsibilities include product design, input procurement, production outsourcing and product finishing and ticketing. It works mostly with brokers representing established U.S. brands, including Gloria Vanderbilt.

Uno-D, a newly formed maquiladora operation, grew out of Maktext, a small-sized apparel-making operation with strong initial links to the Argentinean market, itself a spin-off operation formed in the mid-1990s to help an established textile import firm in Ciudad del Este make productive use of unsold textile inventories. As with Martel, Maktext’s owners view the maquiladora program as an opportunity to deepen their
export knowledge and at the same time, to effect a transition to more stable export markets, including Latino niche markets in the Southern United States. MMKM, a third apparel maquiladora, has original ties to a textile importing business in Ciudad del Este; founded in 2001 and employing 94 workers, it produces pajamas under the Disney label for the Brazilian market.

Maquiladora operations are of course not alone in attempting to diversify and expand their market reach. The milk processing Mennonite cooperative Trébol responded to a flood of cheap dairy imports to Paraguay from neighboring countries by searching for new export markets. It is now exporting pasteurized milk and yogurt products to Argentina and non-perishable items like caramel spread or dulce de leche to Canada. In both cases, the firm uses its links to international Mennonite groups and communities to establish a presence in these foreign markets. Trébol purchases milk from both Mennonite and non-Mennonite families and provides these farmers with on-going technical assistance and training in national and international quality standards.

Several firms have also sought to deepen their role in niche domestic markets. Guaraní Meats, for example, responded quickly to the nation’s foot and mouth outbreak (2001) and related two-year ban on imported Paraguayan meats to Chile—the firm’s traditional market destination—by developing its brand image in select Paraguayan markets. As part of their contract with national supermarket chains, the firm requested use of its own display cases and refrigeration units and received authorization to place highly-trained, uniformed personnel at select supermarket meat counters. This arrangement, through which the firm monitors the freshness and storage of its meat, also provides customers with important information on the company’s health and food safety standards and allows it to demonstrate to foreign clients its continued commitment to quality standards, which facilitated reentry into competitive export markets when the ban on Paraguayan beef exports was lifted. Achon furniture, a family-owned business that has been producing both customized and standard kitchen cabinetry since 1954, competes in the local market by continuously updating its cabinet designs with assistance from Italian designers and its highly trained employees. It provides lifetime service on all installed cabinetry as one way of differentiating its product from those of other producers of high-end and mid-range cabinets. As with many other firms in our study, the company pays above the national minimum wage and invests in vocational training. The company also provides their employees with short-term, no-interest loans to help cover education and housing construction costs, along with annual bonuses for workers with newborn children.

Functional and Process Upgrading (Expanding the Firms’ Range of Capabilities)

Many firms engage in various forms of upgrading simultaneously. The most common arrangement is for firms to combine market upgrading with functional and process improvements, as in the case of Guaraní Meats and some of the other firms mentioned above. These latter forms of upgrading typically involve acquisition of improved machinery and training of employees and are often facilitated by support centers of some sort when these are available and effective. Such upgrading is part of the process of raising labor productivity, essential to continued income growth over the medium and long run. In settings like Paraguay’s recent macroeconomic stagnation and economic instability, such upgrading is often necessary in order to avoid the loss of existing physical and human capital, by finding new ways to use such capital and skills.

An interesting case is Formosa, a medium-sized firm in Ciudad del Este that started out as a wallet-making operation. For more than a decade, the firm designed and manufactured durable, yet affordable men’s wallets using synthetic materials that it sourced from suppliers in China. The quality of its products—itself a reflection of the skill level of its employees—allowed the firm to out-compete most other wallet makers in the Ciudad del Este region, and its wage and benefits policy and investment in employee training made it an attractive employer in the region, as did the owners’ willingness to finance, invest in and contract with independent workshops headed by semi-retired employees. Recently the firm’s owners—a Taiwanese couple and their son—have taken steps to transform their operations into a technology-intensive leather finishing and leather belt manufacturing center—the first of its kind in Paraguay. To make this transition, they have invested heavily in new machinery and equipment (state-of-the-art Italian machinery), continued their investment in vocational training, and worked closely with a business assistance center in Ciudad del Este. Similar steps are being taken by Palacio del Músico, a cassette manufacturing and recording firm that is looking to expand into compact-disc manufacturing. This firm has relied on a business assistance center in an attempt to negotiate licensing deals with multinational music companies and to develop training programs for future employees.
Entertainment Media Group (EMG) was founded in the late 1990s by a group of young entrepreneurs with the initial goal of providing media and advertising support for a popular Asuncion-based dance club. It then used its advertising skills and know-how to provide promotional support to other businesses in Paraguay, initially to apparel-makers targeting the country’s middle class, urban youth. As part of this effort, it transformed a promotional circular for its dance club clientele into a monthly, newsstand-ready design and arts magazine that each month features a different Paraguayan clothing designer. To further promote Paraguayan designers and brands, both nationally and internationally, EMG organized and hosted Asuncion Fashion Weekend in October 2003, as well as Fashion Marketplace, a month long trade fair that features Paraguayan-made clothing and footwear. Film footage of both events has been broadcast on Fashion TV in North and South America and has opened up possibilities for EMG to work with other groups in an effort to organize similar events outside Paraguay. EMG employs approximately 30 workers in Asuncion, many 20-30 years of age. There is evidence that the firm is helping to slow Paraguay’s “brain drain” by creating quality job opportunities for Paraguayan artists, designers, computer specialists and business school graduates.

Network Formation

Network upgrading—i.e., the formation of inter-firm alliances and networks to improve supply chain relations and facilitate information exchange—takes on special importance in Paraguay, given the small size of nearly all firms and the need for greater involvement in international markets. In some cases, it is coupled with market upgrading, whereby groups of firms work together to access quality-conscious niche markets at home or abroad. One example involves a group of small and medium sized metal working firms collaborating to create a maquiladora operation with the goal of breaking into competitive export markets in metal furniture and safety deposit boxes.

Network upgrading is especially common among food and agro-processing firms. By creating and deepening alliances with dairy farmers and agricultural growers, downstream processing firms are in a better position to guarantee quality standards and at the same time, make more productive use of farm output. One example is La Pradera, a milk and dairy processing operation located in the southern Chaco. The firm, a spin-off from an established, large-sized Paraguayan poultry opera-

tion, works closely with new Mennonite communities. In contrast to established colonies in the northern Chaco, these newer communities are populated by poor families that have relocated from parts of Mexico and Bolivia. La Pradera, run by non-Mennonite businesswomen, provides them with technical training and assistance, as well as 24-hour veterinary support, services that have helped to eliminate unnecessary milk wastage and, in turn, ensure higher incomes for these struggling communities. La Pradera also plays an important social function by providing the communities with free medical services and transportation. It also helps the community negotiate with key Paraguayan officials in an effort to secure funding for public roads, schools, health centers and related infrastructure, services that established, better-off Mennonite colonies have traditionally financed by themselves.

Similar outreach efforts and networking activities have been undertaken by Pombero, a small apparel firm that makes embroidered shirts for surf shops in North and South America. The shirts are made of a cotton woven fabric called aho po’i—a style that is not only unique to Paraguay, but a specialty product of Manufactura Pilar. Embroidery work is done by hand and reflects indigenous designs that are commonly used to decorate bedding, table linens and ceremonial garb. Pombero works closely with rural indigenous communities that specialize in this form of embroidery work and are collaborating with community leaders to develop this into a sustainable economic activity. As demand for these shirts has grown and other firms, including Martel- Félix and Shopping Británico, have introduced their own line of aho po’i styles, including formal wear, Pombero has increased the amount it pays for this specialized work, in turn setting a higher wage standard for industry followers.

Why Engage in Higher-Order Upgrading?

In explaining their decision to employ “higher road” growth strategies, firm owners often emphasize the competitive advantages gained from this form of upgrading. The focus tends to be on niche market advantages, that is, on firm-level benefits from strategies that target non-traditional markets or those outside the mainstream. One advantage is the ability to attract and retain skilled employees and local talent. Given the country’s small size, knowledge of a firm’s commitment to progressive employment practices is quick to spread. Many of these firms have lengthy waiting lists of qualified individuals and can attract a group of dedicated, hard working seasonal laborers that return to the firm year-after-year to assist with peak season production runs. The firm’s
often encourage existing employees to actively recruit new workers from within their own social and family networks and, in the process, select candidates that are more likely to feel a similar attachment or dedication to the company. The captive nature of their workforce has not only lowered turnover rates but also enabled firms to maintain, and at times, ratchet-up standards for quality workmanship without facing major resistance or the threat of a mass worker exodus. And workforce stability and employee dedication has allowed many of these firms to invest in vocational training without fearing that their skilled workers will be poached by other firms. These labor market advantages facilitate upgrading by enabling firms to make changes affecting worker routine—specifically the structure and organization of “shop-floor” activities. At these establishments, employees not only receive high wages and benefits (both at the individual and family-level), but job security and opportunities for career advancement (through training and in some cases, placement support at other firms).

These firms also benefit from their “above board” or formal-sector business activities—especially paying local and national taxes and satisfying minimum wage requirements—which makes them attractive to large corporate clients, multinational firms and state-owned enterprises, that often require official, traceable receipts and evidence of legitimate business expenses and outlays. It also gives them access to Paraguay’s formal marketplaces, for example in Asuncion’s large shopping malls. Finally, formality enables these firms to experiment with and adopt a range of marketing techniques, from posted billboards and event advertising to radio and television promotion.

Collective Reinforcement

Behavior on upgrading reflects not only a firm’s own benefit calculation but also a wider set of institutional supports and influences. Some of these influences help to explain why many firms in Paraguay do not attempt upgrading of the sort under discussion here. Recent economic challenges—including the national recession and related MERCOSUR crisis—have clearly lengthened the time it takes for individual benefits to be fully realized and thus probably discouraged certain changes that firms might have contemplated. On the other hand, existing social and industry ties both influence and reinforce norms of practice. In some firms, support communities are religious in nature, as in the case of Mennonite colonies and Christian-based associations. In other cases, specific firms have taken the lead in embracing higher-order growth strategies and have encouraged other firms—especially those with whom they have family and social ties—to follow suit. In the process, these firms have helped to “lock-in” or fix a growth standard for their respective peer or kin group. Similarly, many of these same lead firms are active in the administration of formal industry associations and as such are held to a high standard by their industry colleagues and organizational members.

Martel-Fénix exemplifies the lead firm that has worked to diffuse and reinforce higher-order growth standards among a sub-set of Paraguayan apparel makers. Together with the benefits mentioned above, the firm’s founder adopted a flexible employment strategy enabling older workers and workers with young children to reduce their weekly hours and if preferred, work from home using company equipment. During the downsizing of the company’s crisis years (1995-2001), Martel managers provided informal placement services for employees and worked closely with skilled workers to help them find quality positions at more stable or expanding operations throughout Paraguay. The quality of production, employee skill-level and continuous training supports at the company have made ex-Martel employees highly sought after. The firm has actively reinforced its reputation as a quality training site for smaller apparel makers by providing an informal reference service that enables potential employers to call up the company’s human resources department and receive detailed information about the work and training experience of former Martel employees. To paraphrase one manager, when it comes to employment in Paraguay’s apparel industry, Martel is considered “the school,” the training “master.” The company’s dealings with one U.S.-based merchandiser—Wrangler—have helped to further legitimize its labor-friendly practices. Wrangler, in contrast to many other U.S. and European merchandisers, has historically refused to license its products to foreign companies that employ child workers, fail to observe national labor laws, or avoid paying national taxes. Martel’s influence on other apparel operations occurs through spin-off firms started by former managers and employees, as well as through a new generation of apparel makers that have chosen to follow in Martel’s footsteps and in the process have created socially accountable business groups and member-based organizations.

Alfesa, the country’s first official maquiladora operation, was initially designed to help Martel rebound from the recession by targeting more stable export markets in Europe and North America. Alfesa’s formal af-
filiation with and initial financial support from Martel partially explains the firm owner’s decision to employ many of the latter company’s core business practices. Still, there is an element of what might be called institutional internalization in play, in so far as Alfesa’s owner is a former manager of Martel and also former son-in-law of the company’s founder. His interaction with the Martel business and family has certainly shaped, if not reinforced, his own outlook on acceptable business practice. At the same time, it has provided him with an opportunity to observe from close range the management styles and structural supports that have enabled the firm to stay committed to its higher-order development goals. Alfesa’s owner has also been active in promoting his progressive business philosophy to new and existing entrepreneurs through the creation of and support for socially and environmentally responsible business clubs and by acting as an informal mentor and advisor for a new generation of Paraguayan apparel makers such as Pombero. In turn, Pombero’s owner has formed a non-profit organization that gives start-up support and assistance to young entrepreneurs looking to also create environmentally sustainable and culturally sensitive businesses. Recent recipients of these funds include a Paraguayan youth who is working with rural communities to develop sustainable forest management techniques, another who will provide export services and assistance to small-scale honey producers and yet another who is helping to establish a support center for Paraguayan artists. Chacome, a scooter and bicycle maker that follows higher upgrading practices, also actively encourages other firms to follow suit and, related to this, selects for supplier operations that employ similar practices.

These cases suggest an additional reason for policy-makers to provide support for collective higher-order upgrading, by designing business assistance programs that target and bring together small groups of firms. This can provide economies of scale in the use of scarce policy resources, while avoiding the need to and risks of targeting favored recipients for support. At the same time, these initiatives can create inter-firm support networks that are not only self-sustaining, but help to reinforce shared values and learned practice. This is, however, a challenging process. Program start-up delays are common, usually reflecting initial difficulties in firm recruitment (Lowe, 2005), especially in cases like Paraguay where the state needs to prove its capacities, and to learn the tricks of effective provision of group-support. A good first step is to work with pre-existing networks and community groups or “clubs” like those affiliated with Alfesa and Pombero. By working with existing groups and networks, policymakers can also ensure a continued commitment to higher-order upgrading by lead or first-mover firms. As more firms choose to emulate these strategies however, first-mover firms are likely to face increasing competition for market share and resources, including skilled labor. Such pressures might inspire this sub-set of firms to further deepen their commitment to higher-order forms of upgrading. But there is also a chance that these same pressures might induce the leaders to back away from their existing practices, a risk made greater by the many challenges these firms still face.

Finally, even the largest economic players in Paraguay can be encouraged to “buy-in” to and participate in this process of standards diffusion. In Western Mexico, for example, elite members of a local apparel association and especially the owners of larger-sized operations that were not eligible for direct government support were recruited to play a role as model firms for a state-supported collective upgrading initiative (Lowe, 2003). Here, smaller-sized trainee firms learned about new production and marketing processes and management techniques during supervised tours and seminars held at these large-sized operations. In turn, the owners of these firms—many of them elected members of the association’s governing board—used their participation in the program to demonstrate their continued commitment to small firm upgrading. Government officials reinforced this message by praising the work of these firms at key media and association events.

Use of Existing Policy Supports and Incentive Programs

Existing incentive programs and related policy supports have made it easier for many of the firms studied to engage in and stay committed to higher-order forms of upgrading. These include the maquiladora incentive program for firms seeking access to export markets, the 60/90 investment law that enables firms to bring in and test new technologies and capital goods at minimum cost, and the temporary import program that reduces import taxes on foreign-produced materials and inputs used to manufacture final products for export. Both of these latter initiatives are mentioned by firms that are actively engaged in market and functional upgrading, a fact worth emphasizing given the continuing skepticism in the business world with respect to the developmental capacity of the State. Disseminating knowledge of those programs which do work helps to legitimize these policy supports and improve receptivity towards other future efforts.
And policymakers can use these and related policy instruments as downstream upgrading supports for firms that have successfully completed programs in collective problem solving, and in the process reinforce collective goals to pursue higher-order forms of upgrading.

Policy Implications

Further Research on SMEs and Their Workforce

One strand of future research on SME establishments in Paraguay should categorize firms according to their level of commitment to upgrading and their general approach to labor-management relations. Even among the unusually progressive firms whose experiences are reported here there is considerable variation in employee benefits and support, and in indirect employment practices, as evidenced by standard setting for downstream suppliers and subcontractors. And, of course, the situation of that majority of firms that are less engaged in upgrading needs to be understood in order to design policies for them. Firms that are already engaged in upgrading be it marketing, functional or networking, but fail to meet established employment standards may be good targets for temporary government assistance. Economic and social development ministries might consider partnering to provide workers at these establishments with vocational training, as well as additional social assistance through nutritional, medical, housing and transportation programs. In some cases, government officials can work with trained mediators to help improve labor-management relations. This support will likely benefit firms through increases in productivity and as such, will likely inspire a deeper commitment to quality employment on the part of private sector actors. Similarly, firms that are under performing in all areas could be targets for nested supports that provide dual assistance with upgrading and employment standards.

Some of this research should be directed by small business analysts already familiar with and/or embedded within existing Paraguayan institutions. Paraguayan students, especially those trained within national economics, management and education programs may also productively contribute in such research, while simultaneously developing skills and knowledge that may lead to later employment opportunities in the sector. We also suggest greater utilization of existing survey instruments, including the industrial census and household surveys to analyze SME issues. A final, yet equally important direction for future research should focus directly on worker experience, perceptions and concerns.

Using Lead Firms as a Policy and Advocacy Resource

Paraguay currently provides very limited government support for small and medium firms, relying instead on private sector actors or non-governmental organizations. While neutral government supports are certainly available to larger and leading firms in the form of the 60/90 investment law and temporary import and maquiladora programs (described above), more interventionist initiatives designed to impact and improve firm management, upgrade existing skill sets and strengthen inter-firm relations are generally avoided. This neglect is likely to have serious costs. For one thing, by working closely with the sort of progressive firms studied here, policymakers can hope to jump start the local economy, and to reinforce the conditions that keep these well-networked entrepreneurs invested and engaged in the local economy. Well managed interventions can also help stimulate additional rounds of upgrading by encouraging lead firms to deepen and formalize their connections to other Paraguayan businesses, especially those that are smaller-sized and resource constrained. This can be accomplished through supply chain management programs that bring together a range of firms along a given value-chain (i.e., vertical linkages) and through support for industrial clustering and inter-firm mentoring initiatives (i.e., horizontal linkages). Some of the interesting possibilities are to be found outside Asuncion, for example in Ciudad del Este where a growing number of firms have taken steps to broaden their focus beyond basic import-export activities and low-end services. In the case of Cool Seed, for example, a Ciudad del Este engineer—with earlier connections to the Itaipú dam project—built on his knowledge of electrical engineering and specifically air-conditioning installation, to create a high-end, niche product to assist local soybean farmers with seed germination. As mentioned earlier MMKM, a traditional textile importing business has recently integrated backwards into apparel manufacturing. A former cassette "pirating" operation has formalized its operations by establishing a captive client base of Paraguayan musicians and traditional music studios that buy the company’s own brand of recording cassettes. The company, in conjunction with local music studios and with assistance from an NGO, is now taking steps to manufacture and produce audio compact discs. Traditional negative portrayals of this region and a punitive policy environment that narrowly focuses on cracking down on illicit activities and naming (and shaming) those in violation of the law, means that positive “spillovers” and examples of skill recycling can go unnoticed and
Patterns of Productivity Enhancement in Small and Medium Enterprises

Grew out of this initiative. Further case studies should be a key source of learning for public-sector agencies, both with respect to past successes and to earlier policy weaknesses and missed opportunities.

Learning from and Engaging with Non-Governmental Organizations

Business assistance—especially for small and medium sized firms—has historically been outside the purview of traditional development policy in Paraguay. Non-governmental organizations, business associations and consulting firms—rather than government agencies—have taken the responsibility for business-oriented training and upgrading support. Many of these entities are recipients of foreign aid. To date, little formal analysis has been carried out on the payoffs to support services offered by these organizations. A review of these various interventions is needed to provide a basis for planning future public sector support activities. Newly created non-governmental organizations often have a mandate to involve government officials in program design and evaluation and in some cases, an official policy to eventually hand over program responsibility to public-sector agencies. This presents the government with an opportunity to broaden its involvement in business development assistance and to play a greater coordinating role. As one example, the government should consider setting stricter limits on future foreign aid, requiring donor organizations to first consider allocating funds to existing programs, especially those nearing the end of their funding cycle and therefore at risk of being prematurely phased out. Newcomers to Paraguay should be encouraged to first partner with existing, more experienced organizations. Until now, donor organizations have had carte blanche in Paraguay. Some analysts suggest that this has led to program overcrowding, excessive interprogram competition and duplication of services as organizations stray from their original mission or mandate in an attempt to retain their existing client base. Whether this is the case or not, given the Paraguayan government’s lack of experience in this area, carefully selected foreign assistance is likely to remain useful for some time.

Social Partnering for Long-Range Development Planning

Discussions with business owners reveal deep dissatisfaction with existing institutional supports and systems. For example, many are concerned with existing labor laws that restrict certain kinds of flexible labor practices, including temporary employment. Modification of
labor laws must be done only after very serious thought and discussion, however. A first step may be the formation and strengthening of advisory and governing councils that not only ensure greater policy reflection and review, but bring together representatives from the diverse social and economic groups that will be most affected by any proposed institutional or legislative change.

In considering different models of social partnering, the government might look within its own ministries to observe the work of existing inter-sectoral committees and governing boards. One example is the oversight board for the 60/90 investment law responsible for reviewing and approving proposals for capital and intermediate goods imports. It consists of representatives from different government ministries, as well as business owners who represent industries facing considerable competition from imported intermediate goods (e.g., especially metal items and plastics). Rules of consensus allow business owners to reject proposals by firms that are simply looking for government subsidies to replace locally available products with imported goods. At the same time, for a consensus to be reached, those in support of a given proposal must present the group with convincing evidence of its larger developmental value.

**Leveraging Paraguay’s (Negative) Reputation within the MERCOSUR Region**

Paraguay’s government has shown a growing commitment to “clean up” its international image through steps like putting an end to “pirating” activities such as the production and sale of unlicensed music and film recordings, cigarettes, alcohol, and construction materials. While these “crack-downs” are ultimately important, they do have a social cost, at least in the short run as eliminated jobs are not replaced with viable and sustainable economic alternatives (Cabal and Berry, 2004). Curbing the illegal activities should thus, whenever possible, be accompanied by development assistance, which may even be negotiated with the country’s trading partners as part of a quid pro quo involving funding or technical assistance for reskilling, new job and enterprise creation and export assistance (e.g., such as trade missions and other assurances of foreign market access).

And policy resources should be allocated to studying diversity within the nation’s “black-market” with the goal of identifying and approaching possible target firms for upgrading, especially smaller-sized producers and vendors. Ultimately, it is the presence of these softer-supports that will help to ensure a smooth and stable transition from one set of economic activities to another. There is growing evidence that MERCOSUR delegates are recognizing the need for greater regional support to Paraguay and in the process, are considering a parallel policy system designed to strengthen and formalize segments of its economy (Lowe, 2005). As noted above, Paraguayan maquiladora operations have been granted exemptions from regional content requirements established under MERCOSUR. Similar allowances exist in the European Union, where they are complemented by regional development funds available to disadvantaged regions.

Paraguayan officials have in fact experimented with a variant of this “development deal” in recent years, typically involving representatives from the U.S. government and/or U.S.-based corporations. Ideally, bilateral deals of this nature would create lasting developmental opportunities for Paraguay. Past experiences however show a pattern in which the needs of Paraguayan small business owners and their employees are often pushed aside during the deal making process (Lowe, 2005). MERCOSUR may be a more promising testing ground for such arrangements. Brazilian and Argentinean authorities—given their recent dealings with national economic crises—are likely to act in ways that encourage greater socio-economic stability for the region, rather than promoting a narrow set of business interests. At the same time, their links to advanced economies may open up possibilities for negotiating more encompassing deals that provide additional growth and upgrading opportunities for smaller business establishments in Paraguay.

**Notes**

1. For details see Lowe (2005). Firms studied included seven food and agro-processing operations, seven apparel manufacturers, six metal working operations (two of them involved in the transportation industry), two leather goods makers, a wood cabinet manufacturer, a plastics firm, an entertainment and publishing group, and a textile mill.

2. We do not try to analyze or rank the competitiveness of Paraguayan industries, nor estimate a sector’s future growth potential. For a recent contribution along those lines, see JICA/STP (2000).

3. Examples are Achon, Triebol, Makiex, Martel-Fénix, Guarani Meats, Ferpur (an auto parts maker), and Sigma (a food products firm).

4. There are a few exceptions, including a review of small business assistance programs offered by CEPAE in the 1990s, see García Castro (2000).

**References**

Growth and Technological Modernization

Jorge Katz, Melissa Birch, and Nimia Torres

The Current Scene

Contemporary Paraguay shows the aftereffects of a long process of deterioration of its institutions and productive structure, as manifested in the facts that more than half of the population lives in conditions of poverty and the country as a whole suffers from an extreme lack of credibility among the nations of the world. This harsh heritage is also apparent in the country’s low technological level and in the limited effort to raise that level, all of which poses a severe challenge to revitalize the economy and improve its international competitiveness.

However, efforts at technological modernization are not totally lacking in Paraguayan society. In fact such efforts are found in many areas, both at the production level itself and in relevant institutions. For example, in industries like textiles and clothing, medicinal herbs, organic products, agro industry, essences and generic medicines, parquet flooring and other wood products, one can identify efforts to improve products and processes, both in small and medium firms—many of them family based—and in some “large” firms. Together with such efforts one can see attempts at modernization related to the gradual diffusion of the new information and communication technologies (ICTs) and to the adoption of new patterns of consumption on the part of the higher income segments of the society, in lines such as housing and transport. But, in perspective these are really “bubbles” of modernity that are not nearly enough to constitute a true “engine of growth” for the economy as a whole. They involve a narrow fringe of the population and of the country’s productive and institu-