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Background Note

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A post-Washington consensus approach to local economic development in Latin America? An example from Medellín, Colombia

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Following thirty years of Washington Consensus policies, the new millennium saw Latin America adopt a wide range of new economic and social development policies that were leftist-oriented. A new role was seen for the state, including the state at local level. In Colombia, the city of Medellín has spearheaded this new movement for local activism, and the early results of this radical new trajectory have been positive.

This Background Note argues that Medellín's progress in building a 'local developmental state' needs recognition for promoting enterprise and social inclusion. However, it also cautions against complacency, arguing that important adjustments are needed for more rapid and sustainable progress in combating poverty, underdevelopment and inequality in Medellín. The detrimental role of microenterprise development is highlighted as one important aspect of Medellín's policy package that needs rapid re-evaluation.

This Background Note is based on field visits to Colombia in 2010 and early 2011, using data from round-table discussions, case studies of microenterprises and key informant interviews carried out in Medellín.

Background

Since the early 2000s, Latin America has undergone a political and economic transformation not unlike the one that followed the collapse of the Berlin Wall in 1990. Analysts with extensive Latin American experience (notably Weisbrot, 2006) point out that the proximate cause of sea-changes in policy is the failure of nearly three decades (roughly 1970-2000) of Washington consensus policies to address endemic poverty, massive inequality, rising informality in the business sector and social exclusion. In particular, the failure to deal with the link between extreme poverty and inequality, on the one hand, and violent conflict, on the other, has caused much serious regret in many parts of Latin America.

This is especially the case in Colombia, where the fragile but hard-won social accommodation achieved after the 1950s and 1960s period of *la violencia* was undermined by rising poverty and inequality (Hylton, 2006). Many researchers, notably Holmes et al. (2008) have confirmed that these negative factors were important, ultimately, in precipitating the violence that hit Colombia in the 1980s and 1990s.

As Washington consensus policies were coming to an inglorious end everywhere in Latin America towards the end of the 1990s, the anger this caused began to feed through into a wave of new, leftist elected governments promising more equitable and pro-poor economic policies. A new Post-Washington consensus approach to the economy began to emerge based, among other things, on state intervention and pro-active government support for economic development. This included, eventually, high-level support for the re-establishment in Latin America of national and locally-driven industrial policies (IADB, 2010). But even before this shift in *national* government policy took place, a number of countries in Latin America had started to experiment with new radical *local* policies to directly address high local levels of poverty, informality, inequality and underdevelopment, and to (re)build a sense of solidarity and mutual commitment in place of class and ethnicity-based fear and antipathy. Colombia has been described as at the forefront of this new movement, starting with the capital city Bogota (Gilbert, 2006).

We argue here that one city in Colombia is the pioneer in developing a new Post-Washington consensus local economic policy model: the city of Medellín. After more than two decades of very well-publicised narco-industry and paramilitary-driven violence and chaos, Medellín has made significant economic and social progress since the late 1990s thanks to a renewed appetite for local state activism that has proved both popular and effective.

This emerging model of local state activism is known also as 'social urbanism' and is associated most closely with Medellín's Mayor through 2003 to 2007, Sergio Fajardo, although many aspects were initiated a little earlier under Mayor Luis Perez (1999-2003). The model contains very important lessons for Latin America and elsewhere, notably in terms of the potential and pitfalls of pro-active local economic development policy operating in extremely marginalised communities.

Is there an emerging 'local development state' in Medellín?

Policy-makers and academics have tended to focus on national development policies and the role of the 'developmental state' in the most successful European and East Asian economies (for example, Amsden, 1989). However, analysts such as Michael Best (1990) argue that many countries achieved economic success thanks, at least partly, to sub-national development policy interventions. In fact, a 'local developmental state' model (LDS) appears to have emerged in many of the most successful countries and regions, most notably in post-war northern Italy, Southern Germany and in several Scandinavian countries.

This successful LDS model achieved equal success when adapted by many of the East Asian 'Miracle' economies, notably Japan, Taiwan, South Korea, China and, most recently, Vietnam (Friedman, 1988; Wade, 1983, 1990; Whang, 1981; Blecher, 1991). The core idea is that sub-national levels of government can, and should, be pro-active in building the institutional and organisational infrastructures required for growth-oriented micro-, small and medium enterprises to emerge and succeed. This process requires public assets, institutions and funding in the main, but with public agencies productively often linked to, and financing, a range of non-state and private organisations (e.g., Chambers of Commerce, trade unions, universities, regional development agencies) with a real commitment to the overall goals of local and national economic development. Crucially, history shows that the LDS model process builds upon creative forms of local state ownership and control of key enterprises.

Key elements of the LDS approach have evolved in the city of Medellín since the late 1990s. The first element is the financing of the LDS model through local state ownership of some key enterprises and assets that produce a revenue flow to the city. This revenue flow, in turn, allows the city to embark on major longer-term programmes of enterprise and community development.

One perennial problem in Latin America is low tax rates, which translate into under-capacitated and inactive local governments. This has provided the rationale for still lower taxes ('they don't do anything!' or 'they are stealing our money!' are typical business and media responses designed to lead to lower taxes). In Medellín this problem was solved largely through city ownership and very effective management of the main energy company, *Empresas Publicas de Medellín* (EPM), which is mandated to channel 30% of its net annual profit into the city administration's budget. This financial bounty gives the city the fiscal space to engage in economic and social development areas over and above what would otherwise have been possible.

This technique was inspired by the situation in Chile, where the state-owned and well-managed Codelco Corporation, one of the world's major exporters of copper, has long contributed significant funding to the national budget. This secure funding has underpinned, very successfully, regional/local state-coordinated industrial and agricultural enterprise development programmes, with notable global successes achieved in the farmed salmon and soft fruits industries (Kurtz, 2001).

In other areas, Medellín has used public ownership to inculcate solidarity and build a new civic culture based on mutual respect for what governments can do, matched to what private citizens should feel responsible for. Medellín has proved adept at using pro-poor transport policies to link communities together. The Medellín Metro system and MetroCable (ski lifts in the poorest barrio communities), started in 2000 under Mayor Luis Perez, connect the poorest locations with the metropolitan centre, facilitating important family contact for the poor at a comparatively low price. These facilities also provide a rallying point for community pride and a belief that the city is improving. Finally, better communications allow the poor to work in more distant areas, and informal microenterprises to sell their products in the richer markets in the city centre.

The city of Medellín has also developed its own programme of cash grants similar to the very successful *Bolsa Familia* experiment undertaken in Brazil since the early 2000s. The *Medellín Solidaria* programme began with a National Programme *Familias en Accion* (Families in Action), and has been improved in Medellín according to the city authorities that are responsible for coordinating more than 100 other social programmes.

The final LDS-style interventions in Medellín are associated with the *Cultura E* programme established in 2004. Two specific innovations are of most importance. First, a network of 14 publicly-funded business support centres (the local acronym is CEDEZO, *Centros de Desarrollo Empresarial Zonal*). These CEDEZOs are located in the very poorest areas and are designed to support business development by the poor by offering free-of-charge business support services and technical advice to anyone with a good business idea. Working alongside the CEDEZOs is the *Banco de las Oportunidades*, which provides microloans up to $2,500 at a favourable interest rate (0.91% monthly) to establish microenterprises. The end result of both interventions is an increase in the number and quality of the microenterprises operating in the poorest communities around Medellín. Importantly, those in the poorest communities with a good business idea, but lacking the wherewithal (capital, specific skills, contacts, etc.) to take it through to commercialisation, are given the opportunity to do just this. Equality of opportunity (i.e. equal chances to establish a functioning business) is, increasingly, a meaningful concept in Medellín as opposed to just an abstract ideal.

Case study 1: Limited demand at the 'bottom of the pyramid' is the core problem, not the solution

A young man living in Santo Domingo Comuna has been producing frozen fruit pulp snacks at home for a year and plans to create a 'real' business producing a much higher volume of snacks at a new business location.

Because he has had no problem to date selling the hundred or so snacks he produces daily, he simply assumes that selling around 1,000 will be no problem. He therefore remains enthusiastic about his project to rent a business space and hike up production as soon as possible. His snacks are 'the most delicious', he says, and this factor will outweigh all the other factors and will result in him selling all his additional output.

However, on further questioning, he admits that he will have to compete with many others producing almost the exact same simple snack – most of them also attempting to sell locally. Trying to differentiate his product from these other products, or trying to sell elsewhere, would require a much more sophisticated business operation than he could ever contemplate.

Improving and extending the LDS approach in Medellín

While the LDS approach in Medellín is making some inroads into poverty and underdevelopment in the poorest communities, there is, nevertheless, recognition that much remains to be done and that lessons need to be learned from the progress to date and from wider Latin American experience.

Adopt a measured approach to working with microenterprises

One major flaw with the local version of Washington consensus policy has been its unshakable belief in the market, and assumption that local demand constraints simply do not exist. Instead, a local version of Say's Law ('supply creates its own demand') is deployed: it is simply *assumed* that entrepreneurs will find business opportunities if they look hard enough. This idea is quite wrong in practice, however, because one of the *defining* features of the poverty found in poor communities – often termed 'bottom of the pyramid' – is the sheer lack of demand. Premising a route out of poverty upon microenterprises tapping into additional local demand that is simply assumed to come into existence is clearly a problematic approach at the outset.

Even where local producers overcome the local demand barrier by, for example, having a better product that might also sell outside of the immediate locality, there will inevitably be negative 'job displacement' effects that undermine other local producers/sellers, reducing their incomes (i.e. increasing *their* level of poverty). This form of 'job displacement' typically bedevils all microenterprise development programmes to the point where most microfinance/microenterprise programmes end up making no net addition to local employment or incomes (see Bateman, 2010). Therefore, the limited form of microenterprise development is often described as simply 'recycling poverty', rather than facilitating its eradication.

Some have argued that a niche export orientation is the way forward under conditions of intense global competition – finding whatever demand patterns exist at any one time and exploiting them as quickly as possible. However, this not only provides few benefits for the poor (most of the benefit goes to the landowner or foreign investor), it is also highly risky, as has already been shown in Medellín. The export of cut flowers destined for the North American market boomed in Medellín in the early 2000s, but the industry soon disappeared, and with much early investment lost, when new lower cost competition emerged rapidly in neighbouring countries.

These demand-related problems have given more strength in Medellín to the idea that existing local industrial and state demand patterns need to be more fully explored and 'relocalised' as much as possible. In particular, many have noted that the large industrial sector in Medellín has invested only sparingly in developing a local supply chain involving local small and medium enterprises (SMEs). This concern led to the establishment of *Pro-Antioquia*, and other state-business partnerships, all of which aim to explore the potential to generate greater local/regional benefits from the purchasing power represented by these large companies.

More support to convert microenterprises into small enterprises

At the end of the 1980s, Hernando de Soto (1989) famously claimed that informal microenterprises would be the bedrock for the coming economic transformation of Latin America. However, as Davis (2006) and many others have shown, the end results have simply not matched up to the grandiose claims made.

This holds true for Medellín, where the informal sector has mushroomed in recent decades, but the impact on poverty and development has been minimal, if not negative. Almost none of these microenterprises have evolved into informal small or medium businesses. Indeed, the failure rate is very high, resulting in the poorest losing other social, financial and reputational assets when their tiny microenterprise collapses and when they have to repay a microcredit whilst having no source of income (Bateman et al., 2011). Recognising this, the CEDEZOs have emphasised transforming microenterprises into small enterprises. However, this has been a very difficult nut to crack.

The problems start with CEDEZO's lack of capacity to advise and assist with more sophisticated businesses and scaling-up processes. They were established to work with microenterprises, and that is their main competence. Second, the funding packages available through the *Banco de las Oportunidades* are often inappropriate for scaling up because they are too expensive, short term and too small. Third, the process is hit by the demand constraints noted above. Many home-based microenterprises can just about survive by tapping into neighbourhood demand, but a 'real' small business requires larger and more secure demand patterns to become established. Identifying these demand patterns is not easy, and it may be impossible thanks to the sheer intensity of global competition involving far better placed producers.

Case study 2: Moving from 'no-technology' to 'some technology' microenterprises is not always possible

An entrepreneur in the Manrique area of Medellín has been producing cream desserts from home for some years now, and has had success in selling them locally through a couple of motorcycle delivery boys. She earns just enough to make it worth her while.

A plan to scale-up her business into a semi-commercial business has been mooted that would see her increase her output from 30 litres of dessert a day to 300 litres. While she has factored in many important factors – finance, equipment, skills, delivery system – the level of local demand for cream desserts is the one factor that remains beyond the control of those supporting this business; yet it is likely to be the most important factor of all.

By all accounts, the local demand for cream desserts is very limited, so the indications are that such a large additional quantity will not be absorbed very easily. She has been encouraged to tap into non-local demand in the city centre as the way around the local demand constraint, but this would mean building a much more sophisticated business operation than is currently planned. In particular, the technology required to bulk produce cream dessert is expensive and complicated, and she will need ongoing advice and technical support here.

The CEDEZO cannot offer this package of support in-house, so must find a way of locating other providers who might be able to help.

Gender issues are critical

Microenterprises and associated supportive interventions are inextricably associated with women. The informal sector in Latin America is dominated by women micro-entrepreneurs for whom its flexibility often offers the only income generating opportunity. Many microfinance institutions target women, and the microenterprises they support have become synonymous with women's empowerment.

Whilst these interventions have, arguably, recognised the importance of women's work in the informal economy to development (Chen et al., 1997), they may also reinforce women's positions at the margins of development in informal businesses that do not have the potential to grow beyond the micro. As the focus in local development turns from the micro to SMEs, it is vital that the gendered barriers involved in this transition are taken into account and that gender-disaggregated statistics are kept of who is able to take advantage of this scaling up of local development.

There are various factors to consider in ensuring that small enterprise development is equitable from the gendered point of view. The first is household structure. It is generally acknowledged that women worldwide take more responsibility for household labour. The time and effort devoted to this labour leaves them less time to devote to productive work and they enter the market with one hand tied behind their back (Lister, 2003). The extra burden of labour that this constitutes and the consequent paucity of time available for productive labour are crucial barriers to women being able to access the small enterprise sector and scale up their businesses.

Colombia has a high percentage of female-headed households, particularly among the displaced (UN Habitat, 2005) and Medellín is no exception. Often among the poorest, the burden of labour taken on by women household heads has been described as the feminisation of responsibility and obligation (Chant, 2007). *Mujeres jefas de hogar* (Women Household Heads) are targeted by many social development programmes in Medellín, and informal microenterprises are a key way in which they generate income to make ends meet.

The dominance of women in the informal, micro-economy indicates the gendered barriers restricting their access to the formal small enterprise sector. As confirmed in our initial research, those women who are able to make this transition do not, in general, have caring responsibilities (i.e., they have no children or their children are away from home) or they are supplementing the husband's income. This underscores the importance of recognising the multiple burdens of labour that women have (that tend to be categorised as 'unproductive') in ensuring an equitable transition from the micro to the small scale, and monitoring the gendered impact of this change (Moser, 1993).

The CEDEZOs have the potential to support women's transition from micro to small entrepreneur as they are promoting cooperatives, associations and participation in trade fairs to open up new markets. Working communally can allow gains to be made in terms of economies of scale and labour sharing, as well as valuing and building on the networks and relationships that are associated with women's community labour (Molyneux, 2002). However there are various aspects to consider. In Medellín the history of violence and displacement makes it difficult to establish cooperation and trust. The time and effort that goes into servicing and maintaining these relationships tends to fall to women. What's more, the need to maintain community harmony can further restrict demand, given the difficulties of commercial transactions within small communities (Maclean, 2010).

Access to markets outside the community is therefore crucial. The CEDEZOs are well positioned to provide this and clients emphasise the importance of trade fairs and competitions that facilitate access to broader, more affluent markets. Women interviewed who had expanded their businesses successfully with the support of the CEDEZOS often cited these fairs as crucial to the expansion of their business. The training accessed via the CEDEZOs in business management, marketing and specific income generating activities was also key in expanding the business, although rarely did it challenge assumptions of appropriate activities for women. Two of the more successful projects, for example, involved making kitchenware and children's toys. Training is clearly vital to make up for the gendered deficit in human capital that is another barrier for women competing in the market.

Generate more high-productivity SMEs

Mainstream international development agencies concede, increasingly, that Latin America's local industrial development and growth trajectory has an urgent need for a more active state response. The Inter-American Development Bank (IADB) has been notable in calling for a new approach, using its 2010 flagship report *The Age of Productivity* to highlight the potential of what it calls 'Productive Development Policies' (PDPs). According to the IADB, PDPs should become the focus for the promotion and upgrading of key SME sectors, where real productivity growth is most likely to exist.

Confirming what the IADB reports for all of Latin America, we find that the local developmental state approach in Medellín has, to date, made little substantive progress through its promotion of microenterprises. The impetus for serious SME development activity remains pretty much absent, even though the Competitiveness Committee (CPC) and National Planning Department (DNP) for Colombia, which both have local offices and regional departments in Medellín linked formally to the national bodies, have identified strategic sectors for the economy that require concentrated support.

In terms of the CEDEZOs, they have few functional links to other institutions, still less sufficient financial support that might help implement these national goals. As noted above, the typical CEDEZO is geared up to work with the very simplest of microenterprises. However, there is growing acceptance that the CEDEZO network must rapidly develop its capacity to promote and work with more sophisticated business projects, including relatively high-technology based companies.

At the same time, there is growing recognition that the financial package provided by *Banco de las Oportunidades*, while more favourable than other commercial microfinance institutions, is still unsuitable for growth-oriented businesses – interest rates too high, loan maturity too short, no grace periods – while the financial support provided by the wider private sector is not up to the task for the same, and other, reasons (e.g., excessive collateral requirements). It is precisely because the local financial system is seen as 'disabling', as opposed to the more familiar 'enabling', that there is a movement underway in Medellín to establish an SME development bank. Several of the Mayoral candidates (elections are due in Medellín in October 2011) are strongly in favour of this new idea.

Deepening the LDS approach in Medellín

Medellín's enterprise development model has evolved important elements of a putative 'local developmental state' model – one that is emerging in many parts of Latin America as a response to what are widely seen as failed Washington consensus policies. Medellín's proto-LDS model should be applauded for its work to date in helping establish a new economic development direction that looks likely to produce results in the city. Nonetheless, there are obvious limitations relating to limited capacity, funding and institutional sophistication. Accordingly, we think that some important changes are required if the success registered to date in Medellín is not just to be maintained, but also extended into the future.

- Clearer separation between economic and social objectives: notably, the CEDEZOs should be freed from their mandate to help all who come forward with a business idea. Instead, there needs to be more focus on support for sustainable enterprise development, which means identifying and supporting those with the most potential to grow.
- CEDEZOs need a revised mandate to provide technical support that would be most useful to growth-oriented enterprises using new product and process technologies. The promotion of microenterprises needs to be phased out gradually as a development intervention, replaced by an emphasis upon

building innovative small and medium enterprises with genuine growth potential.

- A more powerful financing body is required to complement, if not replace, the *Banco de las Oportunidades*. As noted, with local markets already 'saturated' for most simple items, financing yet more microenterprises is a wasteful trajectory. The recent moves to establish an SME Bank in Medellín could be a move in the right direction.
- Gender constraints need to be addressed and the gendered impact of the change in focus from micro to small enterprises monitored. Gendered divisions of labour in the household and the market tend to leave women represented disproportionately in the micro, informal enterprise sector. In the transition to a small enterprise driven local development model, these divisions need to be challenged and women's contribution valorised.
- There are few links between the nearly 40 local institutions that exist in Medellín and Antioquia region to promote and support social enterprises that can operate alongside the regular commercially-driven business sector. This is especially so in relation to cooperative enterprises, which have real potential in Medellín to provide additional sustainable employment opportunities, raise incomes, provide the poor with greater access to important markets, and generate important forms of intra- and inter-community solidarity.
- Finally, a local industrial policy is clearly required to provide further structure, content and institutional backup to the measures currently underway, especially for policy tools and programmes that might improve the transfer of technology, innovations and knowledge contained within the large enterprise sector, in the many universities in Antiochuia and in the best SMEs. In particular, key growth areas where local comparative advantage already exists, or could be developed locally, need to be identified and the most appropriate institutions and organisational assets upgraded or expanded to facilitate the process of developing small and medium enterprises in these specific business areas.

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