

Developing Local Economies
*Some Basic Concepts and Principles Useful In Designing
and Focusing Our Economic Program**

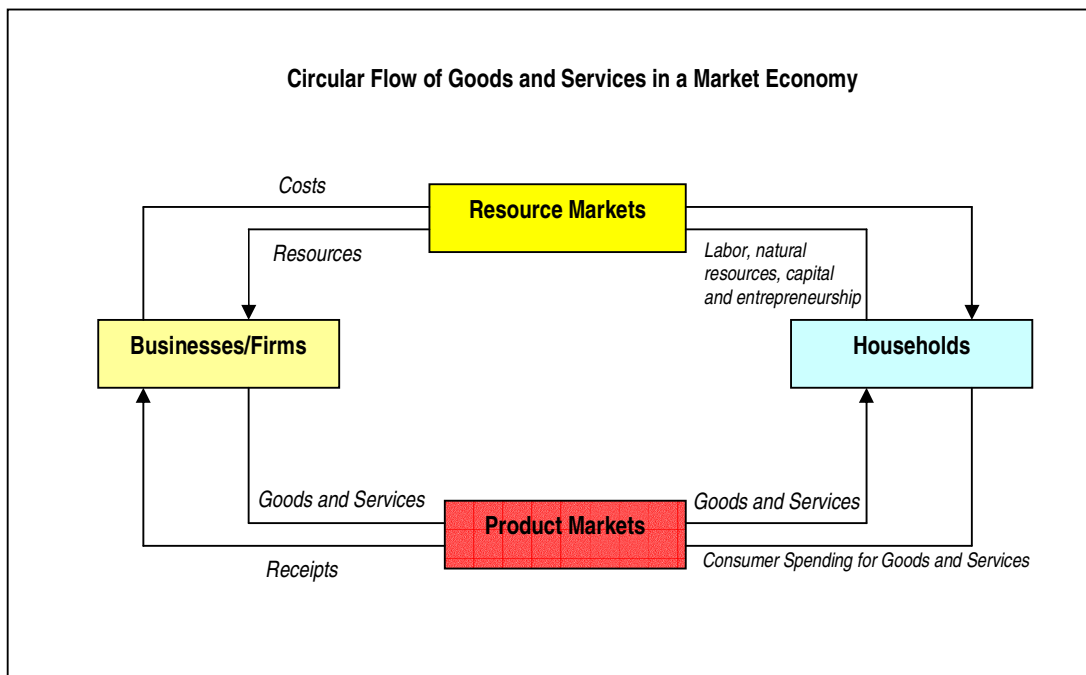
* Concept and think paper prepared by Jay Lacsamana for the Board of Trustees of the Management and Organization for Development and Empowerment (MODE), 09 May 2007. For discussion purposes.

What constitutes an economy?

Economics is the branch of social science that deals with the production, distribution and consumption of goods and services and their management. Scarcity is central to the study of economics. Economic analysis examines how people choose to use limited or scarce resources in an attempt to satisfy their unlimited needs and wants in a very finite world. The Greek word for economics is *oikonomika* or “stewardship of the household” or simply, *house management*. What therefore constitutes an economy? An economy can be a household, community, district, municipality, province, country or continent – anywhere where the problem of scarcity -- production, allocation and exchange of goods and services can be found.

The Typical Economic Model

The typical economic model is the market economy. This model can be represented in the diagram below. In a basic (“pure”) market economy, there are two main actors – individuals/households and businesses/firms. These two actors interact in two major markets: product and resource markets. Households demand various goods and services, say food, shelter and clothing and they buy these from the product markets. Businesses, taking the cue from the demand of households, produce products and services and sell these in the product market. Conversely, in order to produce products and services, businesses purchase from the resource markets (labor, natural resources, capital and entrepreneurship) supplied by households and convert these to final goods and services that satisfy the demand of households.



Market Failure and the Role of Government

The two-sector, two-market model of the economy works only in a perfectly competitive market situation. For it to work and efficiently allocate resources, the following conditions would have to be satisfied:

1. Perfect information
2. No joint consumption
3. No externalities
4. No economies of scale in production
5. Consumers maximize utility, producers maximize profits
6. Competition
7. Freedom of entry or exit in market

In reality, all the above stated conditions cannot always be satisfied in order for the perfectly competitive market model to work. The following are the major reasons that cause market failure:

1. Imperfect information
2. Public goods
3. Externalities
4. Economies of scale

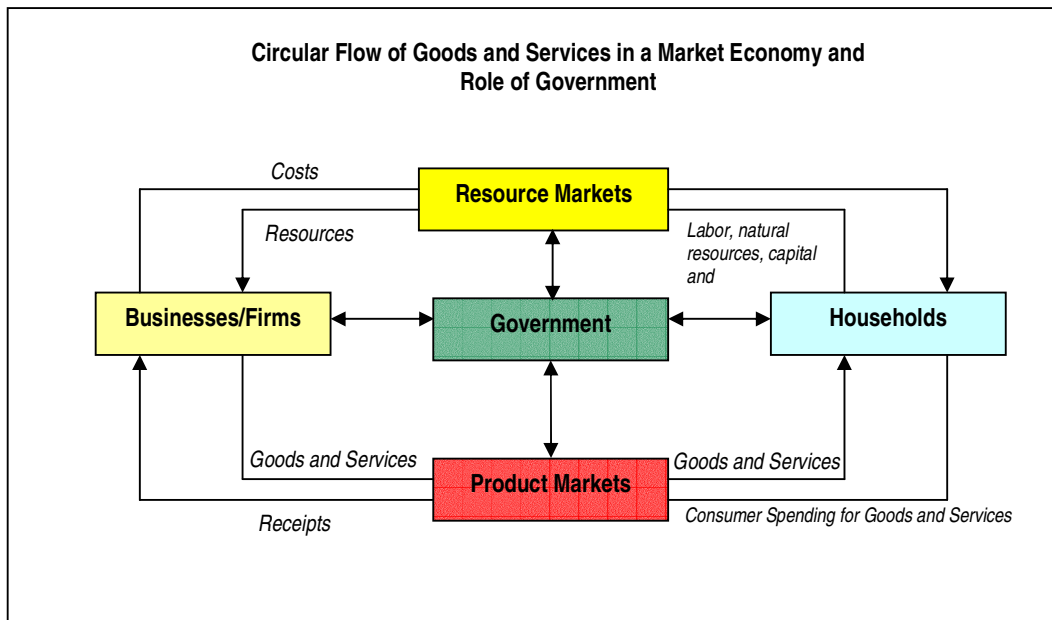
Moreover, beyond market failure there is the question of equity. It is desirable that distribution of income and access to basic services are as equitable as possible. The market system may produce efficient results but are correspondingly inequitable. Poor households, who have inadequate income, may not have the purchasing power to buy basic goods and services at a price offered by businesses. A good number of poor households may also not possess adequate endowments (human capital, for instance -- know-how, skills and abilities) to qualify, participate and derive money income from in resource markets for the businesses to use in its production. In other words, apart from market failures, there is **exclusion** of the marginalized segments of the population in the whole loop of the market economy model.

Market failures, equity and exclusion in the perfectly competitive market system are the reasons why government intervenes.

The role of government intervention is thus:

1. Correct market failures either by participating in the market and/or establishing the rules (regulation and enforcement), and
2. Promote equity and inclusion of the marginalized groups in society.

Intervention in the market to correct its failures and promote equity and inclusion may range from incremental reforms/incentives to more drastic interventions such as revolution or changing the system altogether. In our lifetime, we have seen enough ranges of interventions among different societies in the world. In Germany and Japan, we have seen state capitalism and how extreme government intervention works. At the other end of the spectrum, we are witness to how command socialist economies were set up through social upheavals only to collapse later. Most economies in the world at present practice a mixture of market and state interventions; majority of which practice the market model with some sort of welfare state functions.



Sources of Government (Public Sector) Failures

We in civil society and advocacy work are familiar with public sector failures. More too often, the weaknesses of the market which government

seeks to correct are also the very failures of government intervention. These are:

Failure of Policy Makers

1. Special interest and bias – import liberalization, legislated minimum wage, subsidies
2. Hidden costs, visible benefits concept – physical versus social infrastructure choices
3. Non-selectivity of choices – choice of politicians/policy makers are bundled

Bureaucratic Failure

1. Inefficient and non-competitive bureaucracy
2. Graft and corruption
3. Government budgets are not performance-based

The combined failures of the pure market model and public sector (policy-makers and the government bureaucracy), brings us back to the central problem of development economics and public choice. These are: efficiency in the production, distribution and allocation of scarce resources that brings about equity and inclusion of marginalized sectors.

Civil Society Intervention – Should We?

Can civil society intervene? Yes, on two counts. First, CSOs/NGOs can intervene in the same breadth as a private firm or business may offer to produce goods and services. Second, CSOs/NGOs can intervene by way of influencing governance and changing how government intervenes. On these occasions CSOs and NGOs, in various scales and arena, can both correct market failures and public sector choices; thus they can participate in both making the market efficient and addressing equity and inclusion issues.

Worldwide, the following are the trends in CSO participation in development:

1. Private firms have set-up their own foundations that demonstrates their social responsibility and accountability roles apart from their traditional pure profit motives;
2. Non-government organizations (international and local) have set-up operations for the inclusion of the marginalized and special sectors in development; and
3. Advocacy groups have been established to make government accountable and allow citizens (i.e., the excluded, marginalized) to

participate and share in the exercise of governance and public choices.

Multilateral agencies have recognized the role of civil society and non-government organizations in development. At their best, CSOs/NGOs have significantly built trust or “social capital” and have been instrumental in the education (informal) of the marginalized and poor households/sectors/groups as rightful participants in both the market and public sector choices. CSOs/NGOs have enabled the poor and excluded sectors of society a “sense of community”, equipped them with “life skills” and empowered them to share in the exercise of authority and governance. The work of CSOs/NGOs has somehow staved off the certainty of social revolutions in the areas where they operate.

Are there Civil Society/NGO Failures?

Yes, definitely. These are when they become like government and big business. These are when they fall into the same market and public choice failure trap:

1. Small enclave mentality;
2. When they are co-opted by, or assume the role of government or private sector;
3. Failure to replicate and expand;
4. Failure to grow, modernize and be creative and innovate;
5. Failure to compete; and
6. Failure to disengage (fostering perpetual dependency) and lack of sustainability.

Development NGOs may achieve development breakthroughs in areas where they operate. Through their programs and methodologies, they may be able to efficiently and equitably allocate scarce resources and include the poor and marginalized in the whole process in the areas where they operate. Are these small-scale successes enough to have a demonstration effect across other economic locale? Are these transmittable into government development processes and way of doing things (after all, NGOs are *not* government and are not a position to operate like government in the larger jurisdiction)? Are these successes solely attributed to NGOs or were other actors involved? Are these success stories cost-effective and cost-efficient?

The Economy and the Object of Development

An economy that is efficient in the production and allocation of scarce resources, one that is equitable and engenders the participation of the erstwhile excluded segments, is an economy that ensures genuine

development. It creates wealth and that wealth created is equitably¹ shared and enjoyed by the whole society, with none being excluded in the process.

Thus throughout history, the underlying development problem that the various development interventionists (market, government and civil society) endeavor to address is this: How can the poor² and marginalized participate and share in the fruits of economic growth and development?

Concretely, the poor and marginalized households, in order to be part of the economic growth and development process, need to possess at their disposal the following attributes:

Attributes	Indicators	Household Decision-Making Spectrum of Indicators
1. Human capital - skills, abilities for production/manufacturing employment, entrepreneurship (for self-employment)	Literacy and numeracy Level of education Training and skills level Life skills (organizing, leadership, etc.) Nutritional status	Consume, spend, save, or invest in: <ul style="list-style-type: none"> ▪ Basic necessities ▪ Save for emergency purposes ▪ increasing physical capital ▪ increasing level of human capital (education, etc.)
2. Physical assets – land, machinery, valuable assets (house and lot, jewels, etc.)	Titled land in their name No. and type of production and transport assets No. and type of appliances Jewelries, etc.	Who will work and where (labor utilization)?
3. Money assets – savings after spending for basic necessities, access to cheap sources of money	Income levels Presence and level of cash savings after purchase of necessities Bank-ability	How many children and how soon? (fertility decisions/ choices and family size) Migration decisions (cities, metro or abroad)?
4. Demographic attributes – household size, household composition (age, gender, etc.)	Small manageable household size by choice Average age HH Composition Presence of extended family	Demographic Outcomes: Morbidity Mortality Values: Anti-social Crime-prone

Who are the poor and excluded? Very quickly – they are those who have little education and inadequate employment and entrepreneurial skills to work with, they are those who are landless, they are those who belong to a large family (or have large and extended families), they are nomads perpetually looking for opportunities elsewhere and they are those who may likely sell their values, virtues, votes for food, favor or money.

What Do We³ Do Now?

¹ Equitable, not equal.

² A more technical discussion of who are poor and the measure of poverty is discussed in a separate section

³ The “we” here refers to MODE as an NGO working as a development interventionist in Samar Island. It presupposes that MODE knows what it is and what it represents, i.e. a development NGO that makes operational specific interventions among the rural poor in specific areas in Samar Island in a participatory manner and

We know what works and what fails among the development interventionists – market, government, and CSOs/NGOs. We know that a pro-poor economy is one that is both able to: (1) efficiently produce, allocate and distribute scarce resources, and (2) promotes equity, public welfare and inclusiveness among the marginalized. We know who are the typical poor and marginalized and the indicators or manifestations on how they are excluded from the wealth creation, economic loop.

Where do we go from here? Where do we want to go?

The suggestion is to formulate a framework, one that is comprehensive enough *yet* identifies a focused approach appropriate for an NGO such as MODE. Then we strategize where MODE can focus its work and allocate the scarce resources it possesses. We have to find MODE's niche or "blue flame"⁴, where is it located in the overall framework. Lastly, we identify gaps that can be filled by other like-minded entities (NRBSL, K-5, allied NGOs, etc.).

Local Economy Development Framework

The framework that is seen to address poverty through the development of the local economies stems from the contention that poverty reduction and local economies can happen from the bottom economic unit so long as development interventions are well-targeted, focused and well-coordinated with the effects of other interventions. It argues, "Poverty cannot be eradicated solely with the influx of large-scale foreign investments and revitalization of export industries." It avers that poverty "can be better addressed if the development starts at the bottom: from the local economies growing upward to the national economy". To do so, "local economies on their own must be able to meet the requisites of production, employment and services to be self-reliant and self-sufficient." Thus the character of this development outlook is one that is: (a) bottom-up, (b) micro-led (less on sector, and not macro-led), (c) emanating from households- or household-based microenterprises to the community, (d) less dependent on national government assistance but relies on local government and community/civil society assistance.

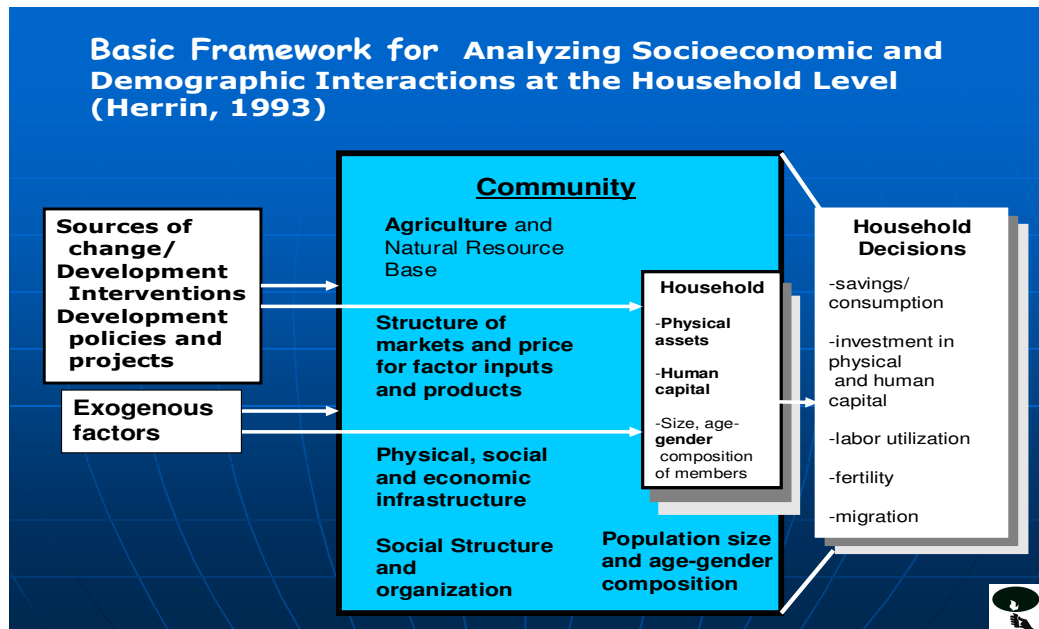
This development outlook has theoretical and practical basis. The Framework for Analyzing Demographic and Socioeconomic Interactions at the Community and Household Level (developed by Dr. Alejandro Herrin, Training Module on Integrated Population and Development

working/collaborating with government, private and civil society entities in the areas towards the development of the local economies of its covered areas.

⁴ In appreciative inquiry, blue flame refers to where skills/abilities intersect with bliss (or what makes us happy).

Planning, 1993), illustrates the relationship between households and the sources of change and factors (in and outside the community) that influence household decision-making (Figure 1).

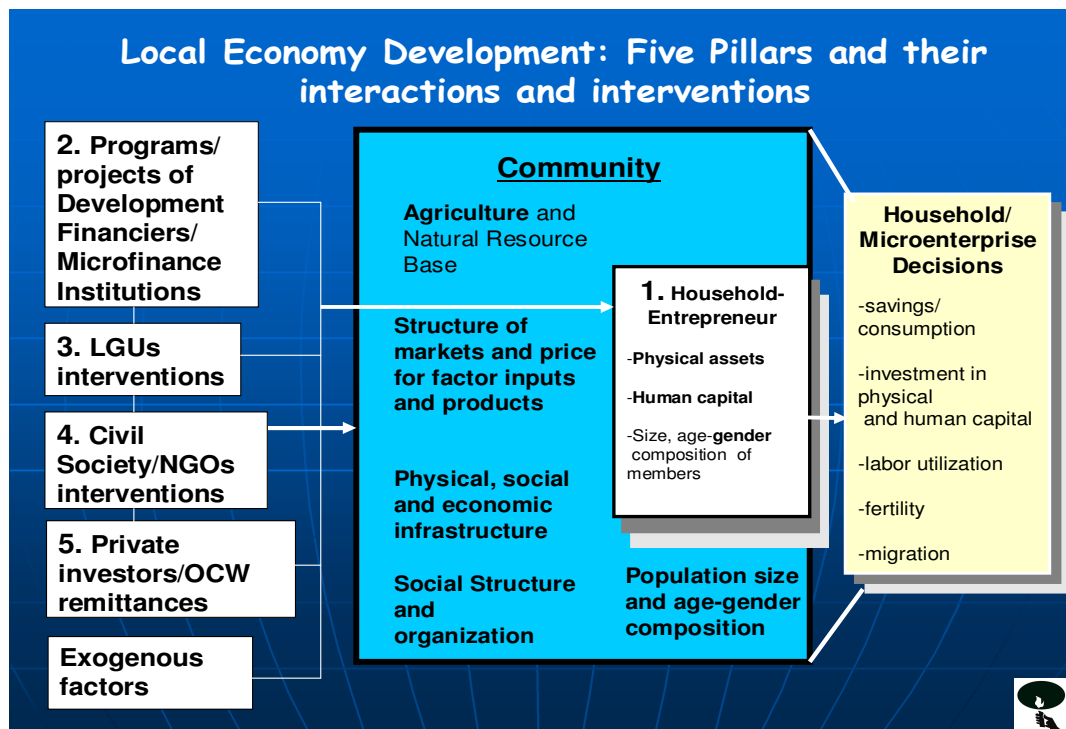
Figure 1: Development Framework for Poverty Reduction & Local Economy Development



The model above shows that household decisions are influenced *primarily* by the socio-economic and demographic characteristics and circumstances prevalent in the household (physical, human assets, size, and age-sex composition) and *secondarily* by the community and external environment. Basic household decisions -- to save or to consume, to invest in physical capital or in health and/or education of children -- depend on the economic and demographic characteristics of households. Decisions on labor utilization (will both adults/spouses work, will the children work?), fertility decisions (how many children or what family size do they want?), shall they move to the city, Manila or seek overseas employment, are all formed by the presence/absence and/or strength/weaknesses of the cited socio-economic and demographic factors. Households are likewise the basic units forming the community or the local economy; they are all in one way or the other and simultaneously: (a) consumers (savers), (b) producers, (c) reproducers, and (d) movers. The predominant choices of households that form the community or local economy shape the economic and demographic decisions and characteristics of the community. The whole system still links to the total picture as the macro-economy and policies on the national economy impacts on the local economy and community.

Above framework is the model used in evaluating if public sector programs and projects (particularly those that address poverty) are effective in creating positive impact on the household and community levels. The framework will be the basic guide in building a more detailed framework or model of microfinance and micro-, small, medium-scale enterprise development, poverty reduction and the development of local economies.

Figure 2: Linkages and Convergence of Development Interventions of the Five Pillars⁵



⁵ The five pillars (i.e., support structure) are **actually the principal development actors in local economy building**. These are *persons, organizations and institutions* that have specific roles in the economy: (1) government (local), (2) private sector business and external investors who have stakes in the locality (overseas workers), (3) civil society, (4) financiers and providers of capital, and (5) poor and entrepreneurial poor (includes those who are success stories and demonstration enterprises and the nascent, emerging ones). Contrast these to the following **principles or modes of conduct that development actors should observe**: good, transparent and participatory governance; non-exploitative, sustainable use of natural resources; gender-sensitive/equitable businesses and investments; participative and empowering methods of organizing; equitable access to productive resources, etc. The latter concepts per se do not build an economy. If basic economics refers to good household management, then the house manager will have to work with the consumers and producers in the household in the how, what, when and wherewithal of producing and allocating household goods and services. Of course, principles or modes of conduct will help the household's well-being (more on the moral and less on the physical) if the members practice the values of honesty, prudence, thrift, respect, etc.

Figure 2 above schematically establishes the linkages and convergence points of the five pillars of poverty reduction and local economy building. The main convergence point is the first pillar: poor households (who are in transition as household-entrepreneurs or “enterprising poor” to become a significant pillar or actor in local economy building). Poor households and the entrepreneurial poor are both objects of development interventions and, at a certain phase and level of success; they eventually become development models and impetus to poverty reduction and local economy building in the medium to long term.

As objects of development interventions, development practitioners recognizes that poor households or those whose incomes fail to meet the poverty threshold or poverty line, need to attain certain levels of social and economic empowerment through public entitlements before they could productively engage in higher-level economic and social development participation. There are certain prerequisites for the significant participation of the poor in the development process and these are access to basic needs like food, shelter, clothing, and public services like health care, formal and informal education, nutrition, potable water supply, irrigation and asset transfer/entitlements like land reform and agricultural inputs, technology and common service facilities.

The pervasiveness of extreme poverty in the Philippines, however, necessitates multi-faceted interventions if one were to transform them from subsistence living to one of sustainable income generation. This will require various interventions starting from welfare provision (minimum basic needs approach and asset transfer) to higher level and sustainable development interventions (capability building for enhancing/generating employment, increasing productivity and value-adding economic activities).

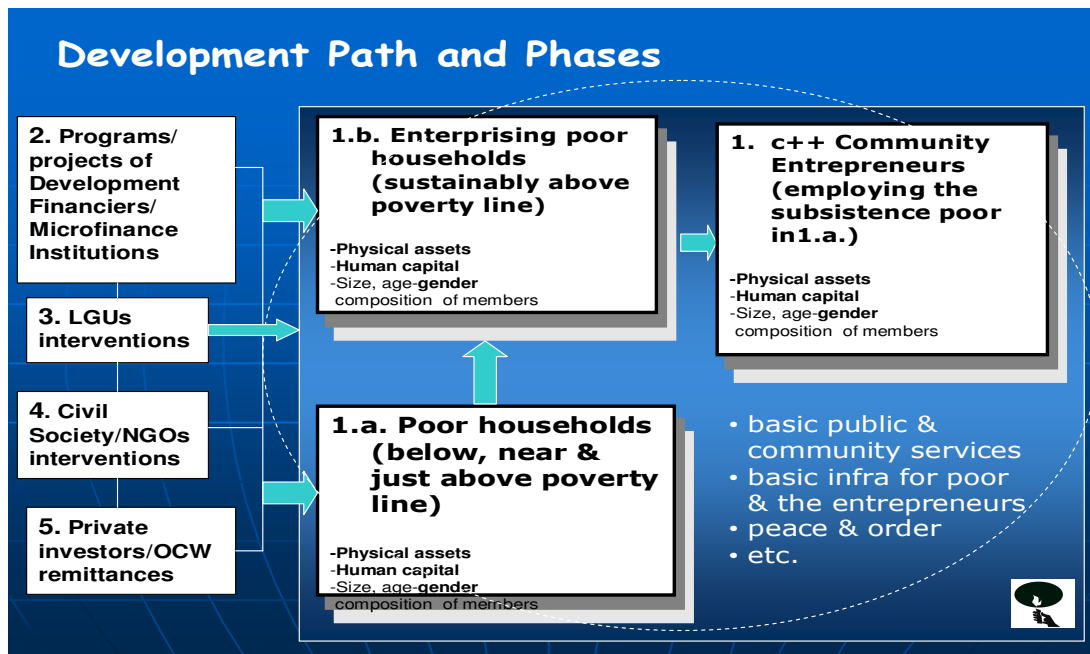
Figure 3 below illustrates the development path and phases aimed at addressing extreme poverty and at the same time instituting interventions among the segment of the poor who are ready to receive, access and, engage in higher-level interventions made available through the interventions of local governments, civil society, development financiers, and private investment streams. The poor and entrepreneurial are divided into three population segments. These are:

- a. Poor households who are below, near and slightly above the poverty line whose mode of economic activity remains predominantly on a subsistence level and may be characterized by low socio-cultural, organizational, entrepreneurial maturity;
- b. The “enterprising” poor households (above the poverty line but whose distance from the threshold is not yet secure due to

proneness to economic cycles) who have attained a level of social/physical capacity, organizational maturity, and entrepreneurial skills to engage in higher-level economic production (in contrast to subsistence economy); and

- c. The community entrepreneurs or the erstwhile poor or enterprising poor with household-based enterprises.

Figure 3: Development Phases and Transition Paths



The poor households living below the poverty line are the targets of interventions mainly (but not exclusively) emanating from the local governance and civil society streams. The main theme is practically provision of welfare and public entitlements directed at outcome that will eventually to put them in a situation beyond subsistence and closer to the second sub-group, the enterprising poor. The enterprising poor, on the other hand, are the main target beneficiaries of sustainable poverty reduction and local economy development through enterprise development. All of the five sources of interventions will come into play and converge towards this population sub-group: local governance, civil society, development financiers, private sector/remittance investments of overseas Filipinos, and successful entrepreneurs (erstwhile poor) microenterprises willing to share their experience and models. Convergence among these actors towards the entrepreneurial poor households ensures that they focus on and harness the major strengths and opportunities open to the target beneficiaries in all sectors of economic activity: agriculture and fishery, agri-business, rural enterprises, commercial, service and industrial sectors. Therefore, by the use of the terms "entrepreneurial" or "enterprise development" the model does not limit itself to business, in the traditional sense of the term.

The outcome of the interventions for population sub-groups 1a and 1b, in a linear causation model, is 1c or the community entrepreneur. At this population sub-group and given a certain level of growth, sustainable, profit-generating and value-adding economic activities are attained and the enterprise operations are now employing the sub-group 1a, the subsistence poor. The framework also recognizes the reality that in certain localities, all three sub-groups may be present and co-existing. The mix varies from community to community: while the subsistence poor may predominantly populate some, the community may still have a handful of community entrepreneurs; other communities may have only a handful of subsistence poor, more of the enterprising poor and insignificant number of community entrepreneurs. The model thus should not construe a purely linear causation concept. The disaggregation of the target population intends to calibrate the interventions of the five pillars so that each population sub-group will receive the appropriate development interventions. The model recognizes that at certain phases, simultaneous administration of the appropriate interventions to the respective population sub-groups may be permissible and appropriate. At some other phase, the predominant administration of interventions (programs and projects) to solely one population sub-group is a better option. The basic criteria are cost efficiency and cost-effectiveness.

Technical Notes on Poverty and Being Poor

Who are the poor? Defining who are poor is difficult. Being considered poor in the Philippines may perhaps be considered non-poor in

Bangladesh or in Aceh. The World Bank defines poor as those earning \$1 and below a day. Those earning \$2 a day are considered “near poor”. In the Philippines, the government defines poor as those earning P12,309 a year or P33.72 a day in 2003. So for a family of 5, that is equivalent to P169 a day per family or P61,539 a year per family. For IBON, a family is poor if it does not earn P435 per day in 2002. The Social Weather Station (SWS) in its surveys defines the poor via self-rated poverty: you are poor if you deem so.

The NSCB determines the poverty line by monetizing the value of minimum food and non-food items. The monetary value of food items is called the *subsistence threshold*. Food items vary across regions/provinces to account for dietary habits and food availabilities and are likewise differentiated between urban and rural. This accounts for the varying poverty thresholds across provinces and regions.

Who are the poorest of the poor? Are they the ones earning P3,000 per family per month? If we take the national figure defined by government as P5,128.25 per month (or P61,539 per year per family of 5), and divide these into quartiles, the poorest of the poor in terms of monthly income are the families earning below P1,282.06 a month. Are the ones earning P3,000 per family a month in Samar the poorest of the poor? No. In fact, the poverty thresholds in Samar are even way below the national poverty threshold.

Poverty Threshold (National) per month per family	P5,128.25
Poorest Quartile 1	P3,846.19 - P5,128.24
Poorest Quartile 2	P2,564.13 - P3,846.18
Poorest Quartile 3	P1,282.07- P2,564.12
Poorest Quartile 4	0 to P1,282.06

Where among the quartiles could we find the “entrepreneurial” poor? This is an empirical question that should be tested empirically. An educated guess would be in quartiles 1 and 2 where the most number of entrepreneurial poor are located. There would be lesser numbers of them in quartiles 3 and 4, although this does not discount the fact that there may be some with entrepreneurial skills in these quadrants.

Purpose-Focus, the Common Weakness of Development Actors

“What do we really want? Side by side, those five words may be the most universally resonant in the English language.” – **Keith Ferrazzi** in *Never Eat Alone*

The common weakness in the plans of development agents (be they government or non-government) is the tendency to craft a very comprehensive and lofty purpose without breaking it down to smaller targets, bite-sized purposes. Work tends to concentrate on the larger picture instead of the jigsaw sized images that make up and compose the larger purpose or “the proverbial forest”. This is aggravated by the weak formulation and definition of its focus, what it will really work on. The tendency is to do many things at the same time, spreading the effort and resources too thinly but barely moving marginally and at best, accomplishing only incremental change.

This is usually how governments work (national and local). Infrastructure projects like feeder roads of equal lengths are constructed in each barangay and sitio without finishing a single and complete farm-to-market access network. A feeding program that distributes food packs across all school children without differentiating and prioritizing among the kids with 2nd and 3rd degree malnutrition cases. There is provision of credit for small livelihood activities without the sustaining components of increasing enterprise management skills and social entrepreneurship. This is not how to manage scarce resources. This is how resources are dissipated – without accomplishing any of the established purposes.

In a nutshell, the framework discussed above provides a comprehensive array of the purposes and roles of each local development pillar. Purpose-focus calls for defining specific niches, specializations and competencies (including competitive and comparative advantages). Thus, in a situation where resources are scarce and when there is a need to focus (read: choose only one course and drop all the rest), the following outline of roles may emerge:

Actors/Pillars	Primary Focus/Role	Principles to Observe
Development Financiers	Provide microfinance in one winning sector	Demand-driven and participatory
LGUs	Provision of public goods (minimum basic needs) and maintain peace and order	Transparency and accountability
Entrepreneurial Poor	Start and go through the enterprise cycle: Demonstration of what worked and develop start-up enterprises (individually and moving on to collective/cooperating enterprises)	Increase savings and investments in entrepreneurial activities
Civil Society/NGOs	Organize to raise level of social capital and organizational maturity of the entrepreneurial poor and their organizations	Participatory and empowering
Private Investors and External Investments	Maintain and establish small businesses employing	Fair competition and employment practices

Examples of Local Economy Building: Purpose-Focus

The following are examples gathered from cursory surfing of local economy building materials in the internet (World Wide Web):

1. Building the Local Rural Economy in Colville, USA

Purpose: Develop the local rural economy

Focus: Develop rural manufacturing by focusing on the specific needs of rural

manufacturers-entrepreneurs

Features:

- Entrepreneur-led and focused
- Creating an environment that enables entrepreneurship to thrive
 - local community assets are built and raised
 - learning from others and learning by doing
- Engage expertise of others, focus on localities and similar regions
- Training and technical assistance
- Financing programs that suits needs of entrepreneurs
- Connection to a University (learning institution) – “Almost all successful economic development in rural America has involved a connection with a university.”

2. Building a Strong Local Economy, San Francisco, USA

Purpose: Rebuild the local economy through innovative and workable plans

Focus: Improving infrastructure, creating jobs and housing, investing in the workforce, neighborhoods and small businesses, and governance reform favorable to the smaller economic players

Basic Feature: Mainly government-initiated and led by the local chief executive

3. Building the Local Economy, Stevens County, USA

Purpose: To build the local economy through the flourishing of local entrepreneurs (or returning residents) who establish high-value products and services that spread out locally, regionally, nationally and globally.

Focus: Ensure that dollars from the outside are brought into the local community through the sales of local products and services

Features/Principles:

- Importance of connection to a place
- The requirement of advanced telecommunications services
- Necessity of a strong sense of community

Conclusion

Successful local economy building, one that is equitable, inclusive and empowering requires singularity and clarity of purpose and a well-defined prioritization and ranking of focused interventions directed at utilization and maximization of resources at hand. At the end of the day, the major themes of economy building revolve around the appropriate mixture of private (market), government and civil society interventions directed at the object and participant of development: the poor and marginalized economic players.

The following are the major strategies in building equitable and participative local economies:

1. Re-channeling and harnessing private investments for businesses and value-added creation that is local-based and is inclusive of small economic players;
2. Making available suitable development financing (from both public and private lenders) for the small and marginalized sectors along viable and local entrepreneurship-engendering economic activities;
3. Good, pro-poor and transparent local governance;
4. Stimulating and increasing social capital of the small and marginalized economic actors; and
5. Civil society focuses on helping the small and marginalized economic sectors organize themselves and increase their organizational capacity and maturity

If scarcity and choice are central analytical focal points in any economic model, the same social phenomena internally omnipresent in development organizations characterize their choice of development interventions. It is essential that these development actors prioritize what

they do best and cooperate with the other like-minded entities in doing the rest of the job.