

## **The Nonfarm Sector and Rural Development: Review of Issues and Evidence**

by **Nurul Islam**

In most developing countries, the rural labor force is growing rapidly, but employment opportunities are not keeping pace. As land available for expansion of agriculture becomes increasingly scarce, nonfarm employment must expand if deepening rural poverty is to be avoided. Policymakers and analysts alike look to the nonfarm sector to increase rural employment, contribute to economic growth, improve income distribution, and alleviate poverty. Expanding opportunities in rural areas outside of agriculture also may help stem the migration of rural dwellers to the cities and slow the spread of urban congestion and pollution. At any feasible pace of growth of large-scale industrialization, urban industries are unlikely to absorb the rapidly increasing labor force. Therefore, it is up to the more labor-intensive rural nonfarm sector to absorb excess labor, promote economic growth, and diversify income sources.

To make good policy decisions, policymakers need firm information about the nonfarm rural sector. The definition of rural varies from one region to another, as does the definition of rural nonfarm activities. The rural nonfarm sector usually includes manufacturing, trade, construction, transportation, communications, and services; some data sources also include income earned by rural family members who commute to jobs in nearby cities and remittances from family members who live and work in cities within the country and abroad. The percentage of rural workers employed in the nonfarm sector averages 20-50 percent but varies from one country to another. During 1970-90 in Asia the share of nonfarm employment in rural employment ranged from a high of 67 percent in Taiwan to a low of 20 percent in China; in Africa, the largest share was 60 percent and the smallest 5 percent. In general, the richer the household and the larger the landholding, the smaller the share of nonagricultural income and employment in the household's total employment and income.

### **Demand and Supply: The Push-Pull Factor**

Demand for the goods and services produced by the rural nonfarm sector is derived from several sources: farm households' demand for consumer goods, their demand for inputs and implements to use in agricultural production, and the urban sector's demand for consumer goods and processed agricultural goods. The response of the nonfarm sector to the demand for its goods and services depends on the availability of labor, access to capital or credit,

availability of infrastructure, and access to technology, including production technology and marketing techniques.

As incomes rise in the farming sector, farm households demand more goods from the nonfarm sector. Small- and medium-sized farm households, on average, devote a higher share of their budgets to nonfarm consumption goods than larger farms do. As agricultural production increases, it generates demand for inputs such as seed, water, and fertilizer and for farm implements produced by the nonfarm sector. The need to process food and agricultural raw materials also stimulates rural nonfarm activities.

Increased employment in the nonfarm sector can be associated with either a stagnant or a progressive agriculture sector: Sometimes nonfarm employment is a way out of unproductive agriculture rather than a response to an expansion of agriculture. For example, many workers in semi-arid zones of western India, where off-farm employment opportunities are limited, have migrated elsewhere or commute to urban areas to work. In this case, workers are being pushed into the nonfarm sector, not pulled by dynamic rural nonfarm opportunities.

The rural nonfarm sector, especially rural industry, not only interacts with agriculture but also has strong ties to the urban sector. While some rural, small-scale industries compete with urban industries, others have a complementary relationship: they produce components for the products of the urban industries or assemble or finish their products. At the same time, urban areas may also provide a market for the products of rural industries.

But household industries—often carried out with part-time family labor—tend to decline when they compete with better organized, small-scale industries in local towns or large-scale urban industries that enjoy the advantages of economies of scale and agglomeration. In other words, when several enterprises of the same type locate close together, they may benefit from an exchange of technical information and from lower costs of inputs to production. Studies have shown that enterprises in small towns tend to grow faster than those in outlying areas. One way that governments can encourage the development of agglomerations of nonfarm enterprises outside of megacities is by providing infrastructure to industrial areas.

### **The Roles of Infrastructure, Education, and Credit**

Infrastructure development, higher levels of education, and increased access to credit are all factors that contribute to the growth of the rural nonfarm sector. The expansion of roads, transport, and communications infrastructure leads to specialization and division of labor by rural households. It promotes the development of a trade, marketing, and distribution network, including subcontracting arrangements linking farm and nonfarm sectors to local towns or

big cities. When rural enterprises can readily obtain materials and market their products outside of local areas, labor costs become the dominant factor in their location.

The expansion of transport and communication facilities linking the rural sector with the cities may also have a negative impact on the rural nonfarm sector. As rural areas become more accessible, competition from cheaper urban or imported products and changes in rural consumption patterns may also result. On balance, however, the net effect of improved infrastructure is beneficial because it stimulates the growth of an efficient and competitive rural sector.

Education—primary and secondary—promotes the growth of the rural nonfarm sector. Literacy enhances the productivity of the workforce and makes it easier to master skills provided through on-the-job training. Secondary education stimulates entrepreneurial capacity. In developing countries, an entrepreneur with an elementary education can expect to earn an income 41 percent higher than one with no education at all.

In spite of new sources of credit, such as credit programs and cooperatives often sponsored by nongovernment organizations (NGOs), the nonfarm sector is still experiencing credit constraints. For example, in Bangladesh, 72 percent of households engaged in manufacturing, 59 percent of households engaged in trade and services, and 54 percent engaged in transport reported that they suffered from credit constraints at current costs of credit.

### **The Role of Government**

If local government institutions have decisionmaking powers and adequate financial resources, they can help promote the growth and vitality of the rural nonfarm sector. In some East Asian countries, local governments have supplied seed capital and managerial expertise, thus shouldering the initial risks of new ventures. Once established, these ventures become small, private enterprises.

Economywide policies such as trade, exchange rate, and general regulatory policies and sector-specific policies such as credit or technical assistance can stimulate the nonfarm sector. In a regime of state control or regulation of imported inputs or foreign exchange and licensing of enterprises, large-scale urban enterprises with easier access to urban-based decisionmaking authorities have an advantage over small, rural enterprises. Deregulation reduces this advantage. Import liberalization is also likely to improve the relative position of small-scale enterprises since the large-scale industries are more likely to be adversely affected by import-competing products. Layoffs of workers or a fall in their wages resulting from the privatization and

deregulation of large public enterprises may stimulate the small-scale enterprises to absorb the lower-priced labor or encourage redundant public-sector employees to start small rural industries.

In the past, technical assistance to the nonfarm sector for training in management, accounting, and marketing has largely been generic: retail trade, services, and industrial enterprises all received the same kind of assistance. Instead, assistance should be customized to meet the needs of a particular enterprise or a group of enterprises providing the same or similar products. For example, public-sector assistance can be linked to government procurement of products and supplies (in many countries, the government accounts for a large portion of market demand).

### **Remaining Policy Questions**

A number of questions must be addressed regarding the evolving nature and future role of the nonfarm sector in developing countries. For example, more empirical analysis is needed on the relative roles and future prospects of nonfarm activities. More evidence is needed on the extent to which employment in the nonfarm sector is the result of a push from stagnant agriculture, rather than a pull from the nonfarm sector. Again, to what extent is the distribution of gains from agricultural growth among farms related to the strength of the intersectoral linkages between the farm and the rural nonfarm sector? How can a decentralized pattern of large-scale industrialization that can stimulate rural economic activities best be promoted? Is the location of small and medium industries in proximity to large urban centers essential for rapid growth in subcontractual arrangements? What institutional arrangements are necessary to enforce contracts between subcontracting enterprises and contractors? How important is public policy for provision of credit to the nonfarm sector? What are the best ways to provide effective technical assistance? How successful are tax incentives and industrial estates in encouraging rural industry? To what extent and under what circumstances does local government help promote the rural nonfarm sector? What role should NGOs play? Answers to all of these questions must be found if the rural nonfarm sector is to fulfill its promise by 2020.

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