Policy Options for Employment in the Rural Non-Farm Sector

Rural development is more than just expanding agricultural output and growth in real per capita agricultural income. In many developing countries, agriculture is not the sole sector — sometimes not even the dominant sector — for household employment and income in the rural sector. Non-agricultural activities in many developing countries often account for as much as 50 percent of rural employment and a similar percentage of household income. This distribution varies across countries and regions, with rural Africa considered to have the most diversified non-agricultural activities, followed by Latin America, East Asia, and finally, South Asia (Reardon et al., 1998).

Even within these regions, however, there is considerable variation across countries, which is sometimes an artifact of very different definitions of 'rural.' The one safe generalization is that the non-farm sector is heterogeneous. This component of the rural economy comprises a wide spectrum of activities and institutional forms, and is often linked in complex ways to country-specific agricultural settings. For a recent survey see Lanjouw and Lanjouw, 1997. It is thus difficult to provide broad policy prescriptions for promoting the sector as a whole, or even to make a case that such a policy stance would be desirable. There is no similar experience in many other parts of the world, testify to the potential contribution of the sector to overall economic growth. Policymakers wishing to promote growth in the rural non-farm economy must sort through the myriad activities and institutions, and focus on those sub-sectors that actually contribute to economic development goals.

These economic development goals are likely to extend beyond the promotion of economic growth. In fact, much of the heightened interest in the rural non-farm sector during the 1990s has been fueled by the hope that the sector can help alleviate rural poverty. In many developing countries, the pace of agricultural growth does not match rural population growth. Governments are thus confronted by the prospect of declining per capita farm output, and possibly an upsurge of rural-urban migration. The hope is that some of the

Selling food often provides an income for the rural poor.
slack in agricultural growth may be taken up by an expanding non-farm sector, and that this growth is broad-based and directly benefits the poor.

This Note provides a brief overview of policy options and emerging lessons about the rural non-farm sector. We look not only at policies that aim to raise income in general, but also at those that attempt to use the non-farm sector as a vehicle to directly combat poverty.

**Heterogeneity of the Non-Farm Sector**

The great heterogeneity of the rural non-farm sector makes an attempt to organize the sector into sub-groups unavoidable. A useful first step in developing a 'typology' is to distinguish, for example, manufacturing activities from service sector activities, and separate employment shares on the basis of gender, location, or other criteria.

When considering the contribution of non-farm activities to poverty reduction, classifying activities by those who principally derive income from them may be another useful criterion. Table 1 shows the average percentage share of per capita income, by source, for the rural population of India divided into fifths. Not only is the non-farm sector an important source of income to rural households, but different types of activities appear to be of differing relevance to the poor.

### Table 1. Income sources in rural India, 1994

<table>
<thead>
<tr>
<th>Income source</th>
<th>Per capita consumption quintile (percentage)</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Bottom</td>
<td>2nd</td>
</tr>
<tr>
<td>Cultivation</td>
<td>38</td>
<td>38</td>
</tr>
<tr>
<td>Agricultural wage labor</td>
<td>27</td>
<td>21</td>
</tr>
<tr>
<td>Non-agriculture</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Casual wage labor</td>
<td>16</td>
<td>15</td>
</tr>
<tr>
<td>Self employment</td>
<td>12</td>
<td>17</td>
</tr>
<tr>
<td>Regular employment</td>
<td>4</td>
<td>7</td>
</tr>
<tr>
<td>Non-agriculture (total)</td>
<td>33</td>
<td>38</td>
</tr>
<tr>
<td>Other</td>
<td>2</td>
<td>2</td>
</tr>
</tbody>
</table>

Source: Lanjouw and Shariff, 1999

**Paradoxically**, the neglect of rural savings that accompanies most government policies aimed at lowering interest rates may stimulate the emergence of at least some types of non-farm activity. Banerjee (1997) describes how imperfections in capital markets can result in rural industrialization in communities where real economic opportunities may be slim, but savings may be abundant.

Finally, agricultural policies can have a pronounced effect on rural non-farm activity. Researchers working on the non-farm sector in recent decades have assessed the strength of the links between the non-farm sector and agriculture. The strength varies across regions and countries, but the presence of some relationship is
nearly always observed. While some of the links might diminish over time, they are probably critical in the initial development of the non-farm sector. An important lesson is that while policies aimed at the rural non-farm sector should not be made without considering their effect on agriculture, agricultural policies should also not be made in isolation.

**Mediating Environment — Education and Infrastructure.** For the non-farm sector, education is important. A number of studies have documented that education levels are very important in determining the type of non-farm activity for individuals, as well as their earnings. Education tends to be more important for employment in the non-farm sector than in agriculture.

The policy message seems fairly straightforward. Efforts to improve education levels in rural areas are necessary to promote employment into higher income, non-farm occupations. Given that the poor are typically the least educated in rural areas, policies promoting education would be expected to favor the poor, providing that a demand exists for additional educated workers. It is possible, however, that education levels have become a criterion to ration scarce non-farm employment opportunities, and education levels are less important for their contribution to human capital than as credentials for selection into these occupations. Raising general education levels could then simply inflate required credentials or shift to some other criteria for selection. Empirical evidence suggests that other characteristics, such as race, gender, or caste, also play an important role in determining the probability of employment, controlling for educational levels.

These observations suggest that expanded education to foster higher non-farm incomes, particularly for the poor, may be less dramatic than suggested at first glance. That said, given the enormous shortfall in rural education in most developing countries, it is hard to imagine much further expansion of the non-farm sector, particularly a skill-intensive, high-productivity sector, without improved educational levels.

The expansion of productive infrastructure services into rural areas is another obvious policy recommendation to promote the rural non-farm sector. There are innumerable studies that document the constrained access of rural enterprises to power and telecommunications, and the high transaction costs caused by inadequate roads. Moreover, there is ample evidence to show that banks, marketing and service centers, training centers, and other support activities tend to locate where infrastructure is adequate (Binswanger et al., 1989).

**Promoting Small Scale Industry**

Projects, rather than policies, have been the primary method to encourage development of rural small-scale enterprise. With project assistance, however, small and geographically dispersed enterprises or clusters of enterprises can be very difficult to reach, particularly in a cost-effective manner — and the number of small enterprises is vast. Even the largest projects, such as the Grameen Bank in Bangladesh with more than 650,000 small-scale enterprise borrowers, are thought to reach only a small fraction of potential beneficiaries.

**Project-level interventions.** Project assistance to small-scale rural enterprises takes many forms. Some projects are designed to help potential entrepreneurs start new enterprises while others assist existing firms. The former often offer a range of services from equipment loans and education in business skills to advice on technologies and marketing. Other projects provide one or two components that are seen as particular constraints to development of the sector.

**Credit programs.** By far the most common form of project assistance is targeted credit programs. These may be operated through government-owned commercial or development banks, private commercial banks, or NGOs. The record with such projects is mixed. Loans from government institutions or mandated lending by private banks tends to end up in the hands of the wealthiest segment of the targeted group because of the high cost of lending to the smallest borrowers with little or no ability to offer collateral. Some projects are quite successful in keeping costs under control, while others are plagued by both high transactions costs and high default rates. On balance, projects that are most successful are locally based, lend to groups, disperse small initial...
loans with additional lending conditional on repayment, and charge realistic interest rates.

**Industrial estates.** With few exceptions, industrial estates targeted at the development of small-scale and rural enterprises have not reached that group, often because the sites and services provided are too expensive. A rationale often provided for government promotion of industrial estates in rural areas is that these will act as ‘growth poles’ and stimulate economic activity.

**Regulations.** India has frequently used the tool of reserving production of specified goods for small-scale or traditional enterprises as a method to preserve certain sectors in the face of competition from modern factories. For example, textile policies instituted in the 1950s did increase employment in the handloom and small-scale powerloom industries, but the export potential of India’s textile industry may have been damaged. Little et al., 1987; Fisher et al., 1997.

**Promoting Casual Non-Agricultural Employment**

Avenues for policy are also revealed when the non-farm sector is broken down into sub-sectors based on wage employment: versus self-employment, and a further breakdown of the former in terms of regularity of employment. In many parts of the developing world, agricultural wage labor and casual employment in the non-farm sector act as a residual source of employment for the poor who are not able to earn sufficient income from cultivation: access regular, salaried non-farm jobs; or engage in self-employment activities. The casual non-agricultural wage labor sub-sector can be viewed as a safety net, keeping those who typically make up the poor from falling further into deeper poverty. Expansion of employment opportunities in this sector helps to reduce poverty in two ways. First, employment in this sector is likely to directly employ the poor. Their income may not lift them above the poverty line, but their income would most likely be even lower without these non-agricultural employment opportunities. Second, expansion of non-agricultural employment opportunities is likely to tighten casual labor markets in general and thus raise wages in the agricultural labor market.

**Decentralization**

The great heterogeneity of the non-farm sector in rural areas suggests that there is little scope for general, broad policy prescriptions. A wide variety of interventions may be required to promote the non-farm sector, each tailored to specific local conditions. Decentralized decision-making may be necessary — mechanisms should be devised whereby local information flows upward so that localized bottlenecks are relieved and specific niches can be exploited. While certain types of policies, for example relating to education and large-scale infrastructure, will remain important for promoting the non-farm sector and do not lend themselves to highly decentralized implementation, there seems to be a clear rationale for also pursuing decentralized policy design and implementation wherever possible. The real challenge is to ensure that greater decentralization does not compromise distributional goals. The gains from decentralization are most likely to be felt in terms of more extensive and productive non-farm activities. It is less clear that decentralization can also be relied upon to ensure that the poor benefit from increased activity levels. It is possible, for example, that more-endowed communities can take better advantage of decentralized funding and implementation mechanisms; or that within a given community, the priorities of local elites are more effectively articulated than those of the poor. Monitoring the distributional impact of the non-farm sector and introduction of measures to enhance the beneficial impact are thus likely to remain important duties for the central authorities.

**References**


This Note was prepared by Peter Lanjouw of the Work Bank. The Rural Development Note series summarizes good practices and key findings about topics related to rural development. These Notes are distributed widely to Rural Family staff and are also available on the Rural Sector website (http://essd.worldbank.org/essd/re/vr/vrhom.nsf/RuralStrategyFolder?OpenView). If you are interested in writing a note, please email your idea to Nwanze Okidegbe (nokidegbe@worldbank.org). For additional copies, please contact Melissa Williams at (202) 458-7297. The ideas posed in this series do not necessarily reflect the policies of the World Bank. Edited by Seth Beckerman, original design and layout by Condello Design, both of Pittsburgh, PA. Photographs by Seth Beckerman.