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TRANSFORMING THE RURAL NONFARM ECONOMY

Opportunities and Threats in the Developing World

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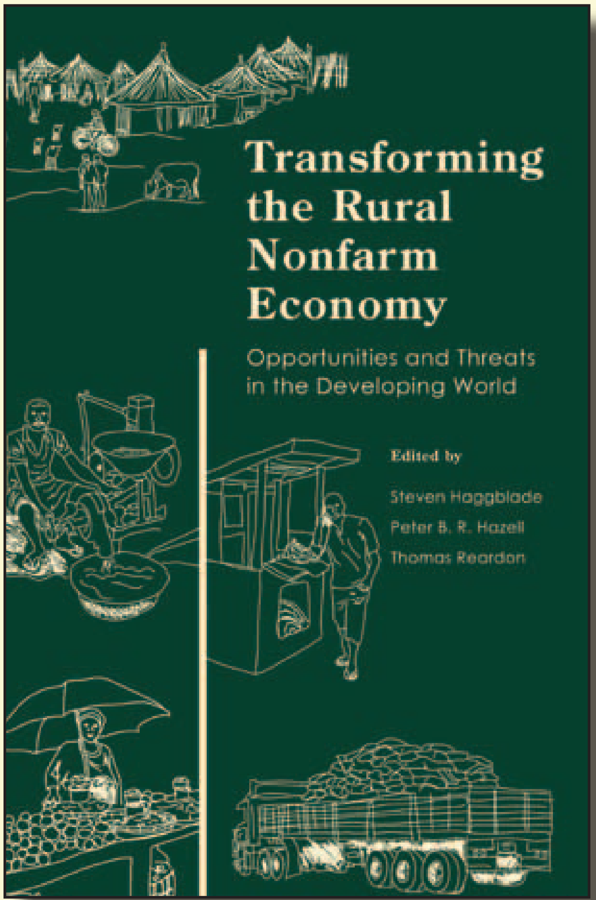
Rural residents across the developing world earn a large share of their income—35–50 percent—from nonfarm activities. Agricultural households count on nonfarm earnings to diversify risk, moderate seasonal income swings, and finance agricultural input purchases, whereas landless and near-landless households everywhere depend heavily on nonfarm income for their survival. Over time, the rural nonfarm economy has grown rapidly, contributing significantly to both employment and rural income growth.



Long neglected by policymakers, the rural nonfarm economy has attracted considerable attention in recent years. In poor agrarian countries struggling with growing numbers of marginal farmers and lackluster agricultural performance, such as those in much of Africa, policymakers view the rural nonfarm economy as a potential alternative to agriculture for stimulating rural income growth. In countries whose economies are successfully shifting from agriculture to other sectors, policymakers see the rural nonfarm economy as a sector that can productively absorb the many agricultural workers and small farmers being squeezed out of agriculture by increasingly commercialized and capital-intensive modes of farming. Given frequently low capital requirements in the nonfarm economy, policymakers in both settings view the rural nonfarm economy as offering a potential pathway out of poverty for many of their rural poor. Expectations everywhere are high.

How realistic are these expectations? Can the rural nonfarm economy indeed grow rapidly enough to productively absorb a growing rural labor force? And in doing so, can it, in fact, provide a pathway out of poverty for the rural poor? A recent book published for IFPRI by Johns Hopkins University Press and Oxford University Press in India, *Transforming the Rural Nonfarm Economy: Opportunities and Threats in the Developing World*, marshals empirical evidence from around the globe to explore these key policy questions. The book, edited by Steven Haggblade, Peter B. R. Hazell, and Thomas Reardon, examines key factors affecting growth and equity in the rural nonfarm economy in order to identify settings and policies that favor rural nonfarm growth and enable the poor to participate in growing segments of the evolving rural nonfarm economy.

CHARACTERISTICS OF THE RURAL NONFARM ECONOMY

Size. Policy interest in the rural nonfarm economy arises in large part because of its increasing importance as a source of income and employment across the developing world. Evidence from a wide array of rural household surveys suggests that nonfarm income accounts for about 35 percent of rural income in Africa and roughly 50 percent in Asia and Latin America (Table 1). Standing roughly 20 percent higher than rural nonfarm employment shares, these income shares confirm the economic importance of part-time and seasonal nonfarm activities.

Composition. The rural nonfarm economy includes a highly heterogeneous collection of trading, agroprocessing, manufacturing, commercial, and service activities. The scale of individual rural nonfarm businesses likewise varies enormously, from part-time self-employment in household-based cottage industries to large-scale agroprocessing and warehousing facilities operated by large multinational firms. Often highly seasonal, rural nonfarm activity fluctuates with the availability of agricultural raw materials and in rhythm with household labor and financial flows between farm and nonfarm activities.

Sectorally, despite many countries' emphasis on promoting rural industries, manufacturing typically accounts for only 20–25 percent of rural nonfarm employment, whereas trade, transport, construction, and other services account for 75–80 percent. Spatially, rural areas house small retailers, cottage industries, basic farm equipment repair services, and input supply firms, whereas nonfarm activities such as schools, health clinics, barber shops, milling, transport facilities, and government services tend to locate in regional towns.

Remittances account for a large share of rural income in some locations. In the mining economies of Southern Africa, remittances may account for as much as half of all rural household income. In most rural settings, however, local business and wage income account for a majority of nonfarm earnings, whereas remittances and transfers typically account for 15–20 percent of nonagricultural rural income and 5–10 percent of total rural income (Table 1).

Equity implications. The enormous variety of rural nonfarm activities results in widely varying productivity and profitability. Returns vary substantially, normally as a function of differing physical and human capital requirements. Poor men and women dominate low-return activities, such as small-scale trading and unskilled wage labor used in construction, portering, and many personal services. Wage labor, in both agriculture and nonfarm businesses, also accrues primarily to the poor. In contrast, white-collar jobs such as medicine, teaching, accounting, and administration figure most prominently among higher-income households.

Because of the differing equity impact of its various components and because of the differing composition of rural nonfarm activity across settings, the overall impact of nonfarm earnings on rural income distribution is mixed (Table 2). In some instances, aggregate nonfarm earnings improve equity across household groups. In other cases, they exacerbate inequality. Empirically, no consistent pattern emerges.

Table 1 Nonfarm share of rural income

	Nonfarm share of rural income (%)		
Region	**Total nonfarm earnings**	**Local nonfarm business and employment**	**Transfers and remittances**
Africa	34	28	6
Asia	51	40	11
Latin America	47	41	6

SOURCE: Haggblade, Hazell, and Reardon (2007), Table 6.1.

DYNAMICS OF THE RURAL NONFARM ECONOMY

The present structure of the rural nonfarm economy results from an ongoing economic transformation that has proceeded for many generations, though at varying speeds in different locations. Historically, agriculture has played an important role in expanding the economic base of rural regions in the developing world. In regions where agriculture has grown robustly, the rural nonfarm economy has also typically enjoyed rapid growth. A large literature on growth linkages suggests that each dollar of additional value added in agriculture generates $0.60 to $0.80 of additional rural nonfarm economy income in Asia and $0.30 to $0.50 in Africa and Latin America. In contrast, regions with poor agricultural potential have seen more limited prospects for rural nonfarm growth, except in places where other important rural tradables, such as mining, logging, and entrepôt trade, offer an alternative economic platform for sustaining regional growth.

In recent years, globalization, urbanization, and improved infrastructure have opened up new opportunities in many rural areas, thereby reducing their dependence on agriculture as the primary engine of rural growth. These developments offer new prospects for stimulating rural economic growth and, perhaps, new pathways out of poverty.

But just how powerful are these new opportunities, and to what extent have they replaced agricultural growth as the main driver of the rural nonfarm economy? Based on the limited evidence available to date, it appears that the new forces of globalization and urban-led rural transformation are proving most powerful in densely populated, rapidly growing countries like China and India. In these settings, where urban congestion, soaring rents, and higher wages raise the cost of doing business in metropolitan centers, rural-to-urban commuting, temporary migration, and urban-to-rural subcontracting become economic. Opportunities for this sort of urban-led rural growth appear more limited in poorer, less densely populated, and more slowly growing economies, such as those in much of Africa. Controlling for national context, regions with better infrastructure and market access seem likely to gain the most from urbanization and globalization, and these regions are often better off to begin with. In contrast, remote backward regions in poor, slow-growing countries will gain the least.

STRATEGIC CHALLENGES

Several key features of the rural nonfarm economy present challenges for any strategy designed to systematically promote the nonfarm sector.

Diversity. Rural regions differ dramatically in their resource endowments, economic structures, institutional histories, asset distribution, and economic performance. Even within a given country—with homogenous macroeconomic policies, demographic profiles, educational systems, and credit policies—situations can differ dramatically from one rural region to another.

Spatial relationships. Intricate, often highly seasonal networks link itinerant and small-scale participants in complex and spatially far-flung supply chains with much larger firms that market inputs or outputs. As a result, rural nonfarm supply chains cut across space and frequently across government jurisdictions, from rural authorities to local townships, urban municipalities, and national ministries and agencies, and even across international borders. Policymakers require some means of organizing thinking, diagnostic assessments, and action that reflects the economic pulsations of the rural nonfarm economy across these spatial and functional landscapes.

Small firm size. The rural poor frequently depend on earnings from self-employment in small-scale, often one-person, rural nonfarm enterprises that are dispersed across rural landscapes. In this setting, aggregation becomes necessary for dealing cost-effectively with legions of small firms. At the same time, asymmetries in power and information between large and small firms raise the potential for oligopolistic abuse of market power.

The fractured institutional environment. In spite of its size and economic importance, the rural nonfarm economy remains an institutional orphan, unclaimed by any single government authority but influenced by many, including local governments; provincial and central governments; ministries of agriculture, commerce, trade,

Table 2 Mixed equity impact of rural nonfarm income

	Share of rural nonfarm income in total income (%) when rural nonfarm income is:					
	Equity enhancing		Neutral		Inequitable	
Quintile	Egypt 1997	Pakistan 1989	India 1999	Ethiopia 1990	Ecuador 1995	Vietnam 1997
Poorest	59	75	32	32	22	40
2nd	52	63	39	—	37	42
3rd	51	36	38	30	37	50
4th	53	33	39	—	46	60
Highest	38	21	31	31	64	82

SOURCE: Haggblade, Hazell, and Reardon (2007), Table 3.1.

communications, transport, health, and education; and private nonprofit agencies. Even large private firms have assumed many formerly public functions, such as the provision of credit and technical assistance and the establishment of market grades and standards.

POLICY IMPLICATIONS

Policymakers hold high hopes that rural nonfarm growth can offer a pathway out of poverty for a large segment of the rural poor. Given the enormous diversity observed across rural regions and within the rural nonfarm economy itself, opportunities, constraints, and appropriate policies will clearly differ across settings. Although general guidelines cannot substitute for detailed understanding of a specific rural nonfarm setting, several broad policy guidelines do emerge from this review. Available evidence suggests the rural nonfarm economy can significantly expand economic opportunities for the rural poor if two conditions hold.

First, the rural nonfarm economy must itself be growing robustly. Both rural nonfarm employment and income per worker must be growing if nonfarm growth is to contribute effectively to poverty reduction. Typically, this growth in the rural nonfarm economy requires investments in the productive capacity and productivity of activities related to rural tradables, such as agriculture, tourism, or natural resource-based activities, in order to ensure their competitiveness in external markets. Alternatively, where low-cost rural labor and low transportation costs coincide, rural households can sometimes compete in urban or export markets through commuting, short-term migration, or urban-to-rural subcontracting arrangements. From a policy perspective, accelerating output and productivity growth in the rural economic base will require investing in agricultural technology, rural education, communications, transportation, and electrification. Together with a favorable policy environment, these investments encourage rural nonfarm business development as well as short-term commuting and migration strategies, both of which serve to increase rural nonfarm incomes and investment.

But a growing rural nonfarm economy does not guarantee access by the poor. Wealthy households, well-endowed with financial, human, and political capital, often prove better equipped to take advantage of growth in the high-productivity segments of the rural nonfarm economy, both as entrepreneurs and as wage employees. Meanwhile, poor households, left to their own devices, risk remaining relegated to slow-moving backwaters of the rural nonfarm economy. Migration opportunities likewise remain bifurcated, with highly educated households more apt to land lucrative positions in towns. Thus, policymakers cannot assume that an expanding rural nonfarm economy will translate automatically into pro-poor growth.

This bifurcation leads to the second requirement for pro-poor rural nonfarm growth: access by the poor to growing nonfarm market niches. For nonfarm earnings to offer a pathway out of poverty, rural households and policymakers may need to invest in rural education and health in order to improve the human capital stock of the poor. At the same time, policymakers will need to remove economic and social barriers that limit poor people's entry into lucrative nonfarm professions. Fluid labor markets, with good transportation and communication systems connecting rural households to regional and urban labor markets, will provide a key bridge linking the rural poor to growing opportunities in the nonfarm economy.

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