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Rural Non-Farm Economy

Determinants of access to rural non-farm employment:

Evidence from Africa, South Asia and transition economies

REPORT V

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Contents

Introduction

This report reviews findings from research on access to rural non-farm employment in developing and post-socialist transition economies. This research has been funded by DFID in the context of its collaborative programme on rural development with the World Bank, and is led by the Natural Resources Institute (NRI) under two different projects. One focuses on India and Uganda whereas the other is being carried out in Armenia, Georgia and Romania.

In India and Uganda the main objective of the research is to improve current understanding on the determinants of access to non-farm employment by the poor and the influence of informal and formal institutions on the development of the rural non-farm economy (RNFE). In Romania and the two former Soviet republics the aim is to address the current deficit of data concerning the structure of rural employment and income in transition economies, and to assess the reasons behind observed patterns. While the research in Uganda is now completed, in all other countries it is still on-going, with several outputs planned for the coming months. Formal/ quantitative panel survey data is currently being processed and therefore not yet available for analysis.

Research methodologies differed across countries:

- Detailed qualitative data was collected at the village level in two districts of Uganda. This was complemented by a small household survey, a review of relevant literature, and an analysis of existing national survey data.
- In India the research is being implemented in two districts of Madhya Pradesh and two districts of Orissa, where a mixture of qualitative and quantitative methods was employed at the village and rural town level.
- A large, nation-wide rural household survey was administered in Armenia, Georgia and Romania. This survey was informed and complemented by field research in two different communities, based on rapid qualitative data collection methods and participant observation. A small enterprise survey was also implemented in each country.

The diversity of methods and contexts provides rich insight on access to non-farm employment and enables a comparative perspective across regions and stages of economic development. Apart from their direct relevance to policy-makers and other public and private stakeholders within case study countries, the research findings and policy conclusions are also pertinent to those concerned with rural development in other parts of the world.

The report is structured in three sections. The first section focuses on the determinants of access to non-farm employment and income at the household and individual levels, while the second reviews key access determinants at the community or regional level. The third and final section highlights key policy issues arising from the previous two sections.

1 Determinants of access to rural non-farm employment by households and individuals

1.1 Introduction

Individuals and households in rural areas are differently positioned in terms of their ability and motivations to engage in different types of non-farm employment. Asset endowments and the cultural environment go a long way in explaining diverse RNFE participation patterns and dynamics at the household and individual level. This section reviews evidence regarding the importance of six factors: i) education and skills; ii) social capital; iii) caste, ethnicity and religion; iv) gender dynamics; v) land ownership; and vi) financial capital.

While the influence of individual factors on non-farm employment is analysed separately, it must be noted that this offers a rather simplistic view. First, the value of a specific asset is typically dependent on the availability of other complementary assets, meaning that assets are of most value when used in combination. Second, the importance of particular assets varies with the type of employment. For example, education and contacts are particularly important for accessing formal jobs in government or the private sector, whereas skills acquired outside the schooling system and access to finance and market networks play a significant role in the development of entrepreneurial activities. Third, the availability of a particular asset often influences the level of other assets. For instance, social capital may enhance access to financial resources; education tends to be positively correlated with social capital and access to formal credit; land availability can serve as collateral for bank loans; and so on. Finally, asset endowments are neither static nor necessarily cumulative over time. For example, households may decide to alienate certain assets, such as land or savings in kind and cash, in order to acquire other assets, such as education and equipment.

1.2 Education and skills

A positive and significant association between education levels and non-farm income at the household and individual levels has been empirically established in different developing country contexts (see for example Barret et al, 2001; Coppard, 2001; Deiniger and Olinte, 2001; Reardon et al, 2000, Reardon, 1997). Better educated individuals are likely to possess skills which facilitate successful involvement in non-farm activities, including the ability to manage a business, process relevant information, adapt to changing demand patterns, and liaise with public and private service providers. They are also likely to have greater aspirations with regard to working outside agriculture.

Some of the studies under review illustrate the important role education plays in enhancing access to non-farm employment opportunities and incomes. In Uganda, secondary school education was identified as a prerequisite for salaried employment in the government and NGO sectors (Cannon and Smith, 2002; Smith and Zwick, 2001; Zwick and Smith, 2001). Also in Uganda, better educated individuals were found to play an important leadership role within group enterprises (Cannon and Smith, 2002). In Armenia, lower education levels amongst the Yezid population is seen as explaining, at least in part, their lower involvement in non-farm activities (Kharatyan, 2002). In two counties of Romania, rural enterprises where the manager has a university degree were found to have significantly higher turnover per worker than other firms (Davis and Gaburici, 2001). In this country, rural entrepreneurs that have successfully diversified into non-farm activities enjoy higher education levels than the respective county and national averages (Davis, 2001). In many communities of Madhya Pradesh and Orissa, education has been identified as one of the factors that have enabled some individuals to develop successful non-farm businesses (Rath *et* al, 2002; Som *et al*, 2002). Broader findings show that in India, the educational attainments of individuals employed in rural non-farm activities are higher than those of individuals who have agriculture as their main occupation, albeit this pattern is stronger for formal employment outside the locality and for non-household manufacturing activities (Coppard, 2001).

However, relatively high educational levels are by no means a guarantee of remunerative wage or self-employment in the non-farm economy. Complementary assets such as finance[1] and a dynamic rural labour market are equally important. The latter is particularly adverse in post-socialist transition economies, especially within the CIS countries, where real salaries in the public sector have fallen dramatically since the start of the transition, sometimes below those earned by unskilled agricultural and non-agricultural workers, forcing state employees to diversify into farming and non-farm businesses to complement their meagre salary income (Davis *et al*, 2002; Kharatyan, 2002; Kobaladze, 2002; Janowski and Bleahu, 2001)[2]. In countries such as Armenia and Georgia, unemployment among rural graduates is high, reflecting the limited formal job options in economies undergoing severe re-structuring and prolonged recession (Kharatyan, 2002; Kharatyan and Janowski, 2002; Kobaladze, 2002; Davis, 2001). In both countries, many of the younger and most entrepreneurial members of case study communities have migrated abroad in search of better income earning opportunities. Similarly, salary employment opportunities in Ugandan villages are practically non-existent, while those available in rural towns are extremely limited, reflecting a private sector that is still at a very incipient stage of development (Cannon and Smith, 2002). In the case study villages of Madhya Pradesh unemployment among the educated youth is widespread (Som *et al*, 2002).

Moreover, the usefulness of formal education for successful participation in the RNFE is not always evident. The skills required to engage in many rural non-farm activities are either very simple or acquired outside the formal school system, through relatives and friends and on-the-job training (Cannon and Smith, 2002; Som *et al*, 2002; Coppard, 2001; Zwick, 2001). The potential inadequacies of the schooling system in imparting some much-needed skills are particularly evident in the post-socialist countries, where the rural adult population is relatively well educated but largely lacks the technical, managerial and entrepreneurial skills needed for successful participation in a market economy (Wandschneider and Davis, 2002; Kharatyan, 2002; Janowski and Bleahu, 2001). In Uganda, the formal educational system is considered to have a traditional and narrow focus on academic disciplines, leaving students with deficient social, technical and life skills (Cannon and Smith, 2002).

[1] Access to finance is discussed in section 1.7.

[2] In view of the very low and irregular government salaries, the willingness to remain employed in the public sector is largely explained by the lack of alternative income-earning opportunities and the social respectability and access to networks and resources often associated with this type of employment (Davis et al, 2002).

1.3 Social capital

Social capital at the individual level, defined by Fafchamps and Minten (1998) as the degree of interaction with others in the context of social networks, can enable economic agents to reduce transaction costs and partially address access constraints arising from imperfect markets. Social capital can translate into access to relevant market information and buyers, wage employment and business opportunities, formal and informal loans, cash advances, inputs on credit, skills, shared resources for production and marketing, and migration opportunities. Many examples of social networks and contacts being used by individuals and households to enhance their asset base and access income-earning opportunities were observed and reported in all studied regions.

Using data from Sub-Saharan African countries and regression analysis, Fafchamps and Minten (1998) show that social capital has a positive effect on traders' sales and gross margins. In his study of the non-farm economy in Mexico, Lanjouw (2000) found that rural communities with a higher social capital index were less likely to be poor. Data on social capital is rarely available, and therefore it is unsurprising that few studies have tried to measure quantitatively the impact of social capital on rural non-farm employment and income. Although none of the studies here reviewed attempts to estimate the importance of social capital as a determinant of non-farm employment and incomes, they provide useful insights into this issue through the use of qualitative research methods.

It must be stressed that a very unequal distribution of relational capital can lead to social and economic outcomes that are both unequal and inefficient. The experience of many post-socialist transition countries illustrates this problem. Members of the old *nomenclatura*, including government officials and managers of former state enterprises and co-operatives, have capitalised on strategic contacts and personal relations developed during the socialist era to access assets, resources, information and opportunities (Janowski and Bleahu; 2002; Kharatyan, 2002; Kobaladze, 2002). For example, privileged access to political and economic networks has translated into acquisition of state assets during the privatisation process, an ability to circumvent complicated and unclear enterprise registration procedures, access to scarce market opportunities and credit, and participation in donor and NGO rural development programmes. In contrast, the majority of the rural population has been marginalised from such processes. In other words, the concentration of critical social capital in the hands of a privileged minority has acted as a barrier to entry into business by the majority, thus inhibiting competition in product markets. At the same time, it has generated widespread mistrust in government institutions and a generalised sense of unfairness in social arrangements, which risks undermining prospects for future growth and development, for example through its negative impact on taxation revenue and provision of public goods.

Despite these caveats, other forms of social capital have played a strategic role in sustaining household coping and livelihood strategies during transition, and those households and individuals lacking relational capital were found to belong to the poorest sections of their communities (Kharatyan and Janowski, 2002; Kobaladze, 2002; Janowski and Bleahu, 2001). Co-operation along kinship, neighbourhood, religious and ethnic lines is often behind successful migration abroad. Trust and reciprocity is intrinsic to many economic transactions within and beyond the community. Exchange labour in farming and barter are common practice. Co-operation has enabled some individuals to obtain informal loans to start their own business outside farming and to share inputs and transport. Retail sales and service provision often comprise a gift and/or credit element, but cases have been found where business profitability and viability have been undermined by such practices.

Group strategies illustrate the potential of social capital to address credit and market access constraints, improve access to service provision, and overcome barriers to entry into income generation activities. In Uganda, severe disruption to traditional family structures during the 1990s as a result of AIDS and the consequent rise in the number of widows and orphans, has led to the spontaneous formation of women self-help groups which pursue common social and income-generating objectives (Zwick and Smith, 2001). Producer groups have also emerged in many parts of the country, often with the support of NGOs. Group enterprises in Uganda have in some cases been found to enhance access to non-farm activities and to improve the returns associated with those activities, but their benefits and sustainability remain critically depend on the managerial and entrepreneurial skills of group leaders and members and the extent of intra-group conflict (Cannon and Smith, 2002; Smith and Zwick, 2001; Zwick and Smith, 2001). Member skills vary widely across groups, and so does the degree of intra-group cohesion. Moreover, it was found that the poor rarely meet the investment and membership requirements to participate in the more dynamic group ventures, which also tend to be dominated by male members.

Self-help groups have experienced even more significant growth in India, where they have been the focus of much attention from governments and NGOs, especially in the context of initiatives aimed at promoting micro-credit services to the poor, in which case groups tend to be formed by women (Pandey *et* al, 2002; Som *et al*, 2002). However, intervention in this area suffers from many weaknesses, with external support organisations often adopting group formation and development strategies that are clearly top-down rather than member-driven. Moreover, there is an excessive focus on savings and loans, with little attention being paid to self-help groups as a potential vehicle for successful income generation activity development.

1.4 Caste, ethnicity and religion

Despite considerable changes over the past decades, the caste system remains a major stratifying force in rural India, especially at the village level. Field research in Madhya Pradesh and Orissa shows that members of the upper castes tend to dominate local power dynamics and to enjoy better asset endowments, higher social status and capital, and more favourable access to education and information (Dasgupta *et* al, 2002; Pandey *et* al, 2002; Rath *et* al, 2002; Som *et al*, 2002). While participation in economic activity is gradually transcending the traditional caste-based division of labour, the latter continues to play a significant role. For example, the upper castes, especially the Brahmins and Kshatriyas, are reluctant to engage in most activities traditionally assigned to specific low caste groups, which are considered dirty or tedious. Also, in many locations, individuals belonging to certain scheduled caste groups are still barred from agricultural marketing and processing activities because of untouchability practices and face difficulties in attracting higher-caste clients when developing businesses such as grocery shops. For them, migration to urban centres is often the only route to escape strict local caste-based restrictions. Still, opportunities are widening for those of low caste, who are becoming increasingly involved in activities previously undertaken by the upper castes. Likewise, technological changes are gradually reducing the status and psychological barriers to entry into agriculture, transport and other economic activities by those of upper caste.

Ethnicity is also an important determinant of participation in the RNFE, and can play both an enabling and constraining role. For example, the Iteso in Uganda are traditionally agro-pastoralists, and only very recently have they started to diversify into sedentary agriculture and non-farm employment, therefore lacking basic business experience and skills (Smith and Zwick, 2001). More generally, the spatial distribution of Uganda's ethnic groups have in the past influenced the allocation of public investment, with Baganda areas in the central and south-western parts of the country benefiting from relatively advantageous access to economic infrastructure and education and health provision (Smith, 2002). Higher levels of public investment in those two regions have contributed to wider economic opportunities than elsewhere in the country, although the relatively high population density and relatively favourable agro-climatic conditions must also be accounted for.

Ethnicity was identified as a determinant of rural employment patterns in Romania (Davis and Cristoiu, 2001; Janowski and Bleahu, 2001). Romanians are heavily engaged in farming. Ethnic Germans and ethnic Hungarians seem more predisposed to get involved in trade and services. Hungarians appear less prone to search for work outside the community than any other ethnic groups. The Rroma (gypsies) do not have a strong tradition in farming, but those that have received some land previously under the control of co-operatives are now engaged in cultivation activities. Rroma are the most mobile ethnic group and are typically involved in low-status occupations, including the sale of second-hand clothes in markets, basket and broom making, manufacturing of cart wheels and horse shoes, and collection of iron, aluminium, sheepskins, glass and paper for sale as scrap.

In Romania religion can constitute an important basis for accumulating relational and human capital (Janowski and Bleahu, 2001). Members of non-traditional and minority religious cults tend to develop strong mutual support networks, both within and outside the community, due to their small numbers and a general feeling of segregation. These networks were found to facilitate migration abroad and involvement in non-farm activities. In the case of the Seventh-Day Adventists, members tend to have a long tradition of private entrepreneurship because of their long-established refusal to work on Saturdays, which under socialism was a work day for state employees.

1.5 Gender

A gender perspective adds significant insight into rural poverty and livelihood issues. In the reviewed studies, gender has emerged as an important factor influencing participation patterns and trends in the RNFE. However, while some general commonalities were found across studied regions and countries, the role of gender in enabling or restricting access to economic activity also varies from country to country, and within country, from region to region. Aside from wide regional variation, it is also important to acknowledge that the relation between gender and livelihood opportunities and outcomes is not static, but one that evolves over time and varies across socio-economic groups. Ultimately, gender issues must be understood in the context of historical processes and the political and socio-economic conditions found in a given place and society.

The studies under review reveal that the division of labour within the household is partly structured along gender lines:

- In rural Uganda women participate more actively in crop farming than men, whilst the latter are more involved in non-farm activities (Newman and Canagarajah, 1999). Field research revealed that men show greater propensity to diversify into non-traditional occupations, such as carpentry and construction, whereas women were predominantly involved in traditional activities, such as handicrafts and alcohol brewing (Smith, 2001). Fieldwork findings also show that men tend to participate more actively in the crop marketing and to occupy administrative and political positions (Smith, 2001).

- Within India the situation varies considerably, reflecting significant cultural and socio-economic diversity across and within states. In Madhya Pradesh and Orissa many non-farm activities are strictly carried out by women[3] while other jobs are exclusively undertaken by men[4] (Pandey, 2002; Rath, 2002; Som *et al*, 2002). Women are rarely involved in enterprise management and in higher-level positions in the public sector. Generally, both men and women work in agriculture, but average female participation rates in the non-farm sector are low compared to those for men (Coppard, 2001). However, official data needs to be carefully interpreted: its tendency to classify women's work as either non-remunerative domestic work or agricultural labour has been deemed biased and inaccurate, while the practice of only recording primary occupation fails to capture the complex and diversified nature of rural livelihoods. Part-time and casual employment in the non-farm sector is more prevalent among women.

- In the rural areas of Armenia, Georgia and Romania it is men who generally start and manage small and medium-size non-farm businesses, often combining that activity with farming (Kharatyan, 2002; Bezemer and Davis, 2001; Davis and Gaburici, 2001). Both men and women cultivate the family plots and bring the surplus produce to the market. However, women tend to be more actively involved in homestead garden cultivation and petty trade, whereas men normally play a larger role in distant plot cultivation and bulk sales of agricultural produce. Many women undertake wage employment in education, health, public administration, retail trade, manufacturing and other non-farm activities (Kharatyan and Janowski, 2002; Janowski and Bleahu, 2001). In Romania migration abroad is more prevalent among relatively young men, although seasonal migration within the country is a common livelihood strategy for women (Davis and Cristoiu, 2002).

Participation patterns seem largely related to gender-prescribed roles in the domestic and social spheres, and the demands in terms of time and effort associated with such responsibilities. Household duties, such as child care and food preparation, constrain the ability of women to devote considerable time to economic activities. This is especially evident in countries where fertility rates are high, such as India and Uganda. In the areas of Uganda worst affected by AIDS, the burden imposed by domestic duties is exacerbated by the significant rise in the number of orphans and incidence of widowhood (Zwick and Smith, 2001). Household chores restrict opportunities for young girls to attend school, as seen in many rural communities of Madhya Pradesh (Som *et al*, 2002). Gender inequalities

[3] For example, broom and mat making, vegetable marketing, *papad* and *bari* preparation, and puffed rice production.

[4] For example, driver, mechanic, mason, carpenter and livestock trader.

in access to schooling in India are intimately related to the dowry system and the fact that women leave the household unit as soon as they get married (Sen and Dreze, 1996)

In addition, social norms restricting female mobility and ability to work outside the household were identified as an important constraint in many villages in Madhya Pradesh and Orissa, particularly among the upper castes (Rath et al, 2002; Som et al, 2002). In Uganda women rarely own and know how to ride a bicycle (Zwick and Smith, 2001). Gender inequalities in education and skills (in India and Uganda) and relational capital (in all the studied countries) also emerged as important obstacles to female participation in the RNFE.

The position of women as income earners partly determines their ability to influence household expenditure patterns and the distribution of resources and consumption within the household, with clear implications for the well-being of female household members and children (Dreze and Sen, 1996). Cultural norms are another important factor behind intra-household decision-making and resource allocation processes. In Armenia, it was found that women traditionally play an important role in managing household finances, even when male members bring in a larger proportion of cash income (Kharatyan, 2002; Kharatyan and Janowski, 2002). In contrast, in Uganda there is evidence that female-heads face an advantageous position vis-à-vis married woman in terms of decision-making power and control over assets, which facilitates engagement in income-generating activities in the non-farm sector (Smith, 2001). This issue was not explored in the other study countries, despite its importance for livelihood outcomes.

As mentioned, gender patterns are neither static over time nor homogeneous across socio-economic groups. In Uganda there has been a gradual shift since during the 1990s towards non-farm employment, especially among men and female-heads of household (Smith, 2001). The need to sustain the household, combined with greater control over resources, seems to have pushed female-heads, whose number has increased significantly following the spread of AIDS, into non-farm activities. At the same time, there is evidence that income differentials between men and women in the same activity groupings have widened over the recent years (Smith, 2001).

In India, rural non-farm employment over the past decades has expanded more rapidly for men, and recently there has been some overall decline in female participation (Coppard, 2001). Preliminary research findings in some communities of Madhya Pradesh suggest that mechanisation is displacing labour in agriculture, and that the non-farm employment opportunities emerging from such developments, for example in repair and transport activities, are being almost exclusively taken up by men (Som *et al*, 2002).

1.6 Land

The relationship between land endowments and participation in the non-farm economy is a complex one. Theoretically, the relation between landholding size and the share of non-farm income in total household income is likely to be depicted by a negatively sloped curve. The reason is that rural households with good access to land are not compelled to diversify into off-farm employment to the same extent as landless or marginal farming households, and tend to show a strong attachment to farming as a way of life, thereby having a tendency to specialise in agriculture and allied activities. Those with limited or no access to land have to work as agricultural labourers and engage in non-farm activities in order to earn a living, often having to migrate as a response to limited local employment opportunities.

However, an inverse co-relation between land ownership and the share of non-farm income at the household level is not always verified empirically. First, the relative importance of land ownership as a determinant of relative importance of non-farm employment and income across households is likely to lose importance the more equal is the land distribution. Second, access to land is only one amongst many factors that influence employment and income patterns across households. Finally, successful farming may constitute an entry point for agricultural processing and trading and provide financial resources for investment in non-farm enterprises[5], while at the same time constituting a safety net that enables riskier and potentially higher-return household investments. In other words, medium and large farmers tend to be better positioned to engage in more remunerative self-employment in the non-farm sector because of resource and risk conditions.

In Uganda, rural households at the top end of the landowning structure were found to be more specialised than other farming households (Smith and Zwick, 2001; Zwick and Smith, 2001). They tend to concentrate on crop and livestock production while the latter generally undertake a wider range of income generating activities. However, many amongst the wealthier landowners have also developed profitable service-based enterprises in nearby rural towns – such as lodging houses, bars and restaurants –, with income from farming playing an important role in the establishment of such enterprises.

Such patterns were even more evident at village level in Orissa State, where land distribution is generally highly skewed (Pandey et al, 2002; Rath et al, 2002). The poorer – and land scarce – households were found to depend on non-agricultural income to a greater extent than richer – and "land abundant" – households, and to engage in a wider range of non-farm activities. The wealthier landowning households also engage in non-farm activities but on a more specialised basis, often developing enterprises which demand relatively high investment and generate relatively high returns. Examples include milling and retailing. Involvement in wage employment is normally restricted to public sector employment, whereas poorer households depend on low paid – and often casual and seasonal – wage employment in agriculture and non-farm enterprises as a key source of income. Self-employment by the poor is largely confined to activities characterised by low returns, such as collection and sale of minor non-timber products and handicraft making.

Interestingly, land ownership was not identified as an important determinant of participation in the RNFE in the three case study transition countries (Kharatyan, 2002; Kobaladze, 2002; Janowski and Bleahu, 2001). First, the privatisation of co-operative and collective land led to a relatively equal distribution of this asset amongst the rural population. Second, land ownership is not necessarily a determinant of agricultural performance due to acute production and marketing constraints[6]. Many households in these

[5] Obviously, the inverse is also true, with resources generated from successful non-farm enterprises being available for investment in – and development of – agricultural activities.

[6] Production constraints include lack of family labour, unavailability of irrigation infrastructure or incapacity to incur irrigation costs, limited availability and poor quality of agricultural production services, and poor functioning of input supply networks. Marketing constraints comprise, among other, lack of processing and storage facilities and low purchasing power in urban areas.

countries are unable to cultivate part of owned land[7] and subsistence-oriented farming predominates. Participation in non-farm activities constitutes a crucial source of cash income, but opportunities to diversify are conditional on access to financial resources and business skills. Remunerative wage employment opportunities are either non-existent or extremely scarce.

1.7 Finance

In all studied regions and countries, inadequate access to credit was singled out as one of the major constraints – and often the main constraint – to investment and entrepreneurship, hindering the ability of individuals and firms to meet their investment and working capital needs (Bezemer and Davis, 2002; Cannon and Smith, 2002; Davis *et al*, 2002; Davis and Gaburici, 2002; Kobaladze, 2002; Pandey *et al*, 2002; Rath *et al*, 2002; Som *et al*, 2002; Coppard, 2001; Zwick, 2001). This constraint has been found to be especially acute in cases where individuals would like to venture into new businesses or where enterprises are planning to expand activity. Lack of access to formal loans severely affects individuals across the whole income spectrum but the poor face particularly stringent constraints in this sphere.

Although lack of access to credit is widespread in all the studied regions, a note of caution is required. While insufficient capital is commonly mentioned as a critical obstacle to successful engagement in the non-farm economy, this does not mean that it is the only or even most important barrier (Gordon *et al*, 2001). Other business constraints, arising from limited purchasing power within the community and surrounding locations, and from lack of access to outside markets, were acute in most studied areas (see section 2). Inadequate skills amongst existing and potential entrepreneurs were also prevalent. Unless these constraints are effectively addressed, improved access to credit may fail to sustain increased enterprise activity and incomes.

The significance of credit as a determinant of success in rural non-farm activity was only assessed in Armenia and Romania (Bezemer and Davis, 2002; Davis and Gaburici, 2002). In both countries enterprises which had received formal loans recorded on average higher profits than their counterparts. While this finding must be qualified in view of the general tendency for financial institutions to fund larger and more viable businesses, examples of several profitable firms which saw their bank loan applications rejected were identified. Evidence for Romania suggests that access to credit is a major determinant of enterprise investment and expenditure levels.

In all regions and countries studied, credit access problems are a consequence of a complex set of factors operating from the demand and supply sides (Bezemer and Davis, 2002; Cannon and Smith, 2002; Davis and Gaburici, 2002; Davis and Cristoiu, 2002; Davis *et al*, 2002; Kharatyan and Janowski, 2002; Smith and Zwick, 2001; Pandey *et al*, 2002; Rath *et* al, 2002; Som *et al*, 2002; Coppard, 2001; Smith and Zwick, 2001; Zwick and Smith, 2001):

- Distance to financial institutions and lack of awareness about possible credit sources is a significant constraint in rural Uganda but less so in all other studied countries. Interestingly, even the poorest states of India, such as Orissa and Madhya Pradesh,

[7] Some key informants in Romanian villages refer to land as a burden.

possess a reasonably dense network of rural financial institutions, a reflection of decades of pro-active policies and interventions aimed at developing the rural financial sector.

- Collateral problems are common to all countries, and affect the poor in particular. Poorly developed land registration systems and inadequate functioning of land markets play an important role in post-socialist transition countries. In India, many rural households have no or very little land and collateralised assets.

- Corruption amongst bank officials and bureaucratic and inflexible loan procedures were reported in all studied countries.

- In India, a history of default makes many beneficiaries of rural development programmes ineligible for fresh bank and co-operative loans. Widespread allocation of credit for consumption purposes, including dowry, is one factor behind high default rates. Significant default rates were also found in Uganda. Lack of business experience and market access problems contribute such high default rates in the two countries, while the burden imposed by dowry customs is an important factor in India.

- Aversion to debt, partly due to high nominal interest rates and the lack of profitable business opportunities, was common even amongst commercial-oriented rural entrepreneurs in Armenia, Georgia and Romania. Lack of entrepreneurial experience and an adverse investment environment may partly explain their reluctance to take on formal loans.

- In Romania, delays in the privatisation of banks, inappropriate regulations, and poor management have contributed to a series of bankruptcies in the banking sector.

The above problems are largely structural in nature, reflecting in part current stages of economic development in studied areas and the high transaction costs of servicing small and dispersed entrepreneurs. However, inadequate policies can also play a role, as illustrated by the Indian example (Coppard, 2001). An expansion of the rural financial sector and subsidised credit delivery to target activities and socio-economic groups has been one of the cornerstones of Indian rural development policies since independence. While active government intervention has led to the development of a reasonably dense network of rural bank branches, thereby reducing the physical distance between lenders and borrowers, such policies have created distortions that act as access barriers to many rural households and entrepreneurs. For example, excessive regulation and target-driven agendas have resulted in inflexible and lengthy lending practices, characterised by very high transaction costs, which proved ill-suited to meet borrowers' needs. In addition, one-off subsidised loans and waivers granted to defaulters have provided limited incentives for re-payment, being partly responsible for a widespread culture of default, which has reduced the credit-worthiness of rural producers and the willingness of bankers to lend them. Moreover, the preference accorded to certain activities and groups – often based on social and political rather than economic and financial criteria – has crowded-out emerging non-farm activities and enterprises with growth potential. Since the 1990s, governments have been trying to address these problems through an increased emphasis on informal group approaches to credit and a gradual re-structuring and de-regulation of the banking sector. While far from complete, these reforms seem to be bearing fruit, having resulted so far in an improved performance of the rural financial sector and a more balanced allocation of credit with respect to gender, type of firm and economic activity.

Given the adverse scenario in terms of access to credit in all studied countries, the scope for developing rural non-farm businesses is largely dependent on household savings, ownership of assets that can be easily converted into cash, and access to informal sources of funds (Cannon and Smith, 2002; Janowski and Bleahu, 2001; Kharatyan, 2002; Kobaladze, 2002; Pandey *et al,* 2002; Rath *et* al, 2002; Som *et* al, 2002; Gordon *et* al, 2001; Zwick, 2001). Advances or loans from relatives and friends and migration remittances were found to play a critical role. Informal moneylenders are still an important source of funds in rural India, but interest rates are high and loan maturity short. In Uganda there is no tradition of village moneylenders, but some incidence of informal rotating credit associations was observed. While informal credit services have several advantages over formal credit – including greater proximity to clients, lower collateral requirements and lower levels of bureaucracy –, they generally involve relatively small sums and rarely comprise longer terms loans.

Paradoxically, poorly functioning rural financial systems may in some contexts stimulate an expansion of the RNFE (Banejee and Munshi, 2000; Vijverberg, 1988). The reason is that lack of savings mobilisation by the formal financial sector and poor financial intermediation between rural and urban areas may lead to a situation of relatively abundant rural savings being invested locally in relatively low return non-farm activities. In such situations, a deepening of financial systems would lead to an increased outflow of rural savings towards more profitable opportunities elsewhere.

2 Wider determinants of access to non-farm employment

2.1 Introduction

The previous section examined how the levels and distribution of human, social, physical and financial capital across individuals and households influences their relative ability and motivation to engage in non-farm economic activities. It also looked at the importance of gender dynamics as a determinant of labour division between men and women. Evidence from five case study countries illustrated the discussion.

While asset endowments and cultural aspects help explaining patterns of participation in the RNFE within a particular location or region, they offer only a partial picture. Access to non-farm employment and income is not only a function of people's inherent characteristics and assets, but also a product of wider factors and their influence on available employment and investment opportunities. In other words, while an understanding of how different households and individuals are differently positioned to exploit existing opportunities in the non-farm sector is certainly relevant for policy processes, it is equally important to consider those factors that determine the level and type of opportunities available. In order to do so, one must go beyond an examination of the supply factors at the household and individual levels and the social and cultural institutions that condition how assets are used by households and individuals within their strategies of participation in the RNFE.

Some of these wider factors are reviewed in this section. They influence opportunities in the non-farm sector mainly through their impact on local intermediate and final demand, access to outside markets, and the cost and risk of doing business. Levels and patterns of local demand are critically important since a large proportion of rural non-farm economic activity typically caters for relatively circumscribed markets, a pattern that has been confirmed in all case study areas[8]. Conditions of access to outside markets are crucial for the development of agriculture and non-farm tradable activities in which rural areas may enjoy a comparative advantage, including tourism and the extraction and/or processing of natural resources[9]. "Exports" to outside areas act as key drivers of local economic growth due to their impact on income and demand levels in a given region. Finally, the cost and risk of doing business in rural areas influences the levels of inward and outward investment.

2.2 Agricultural development

The research in Uganda, India and the three CEE/CIS countries confirms the critical importance of agricultural development for creating an environment in which the non-farm sector can prosper. The inter-related development of the agricultural and non-farm sectors is mediated by linkages operating from the supply and demand side. Increased produce

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[8] The localised nature of markets for most rural non-farm activity is a consequence of the non-tradable character of retailing and most services – tourism being one of the few exceptions – and the fact that goods manufactured in rural areas often cannot compete in distant markets due to their low value to weight ratio, the existence of similar products or superior substitutes elsewhere, or both. Examples of goods which often can only compete within fairly circumscribed areas include furniture, handicrafts, construction materials, bakery products and traditional alcoholic beverages.

[9] Manufactured "exports" with poor links to the natural resource base are possible but less likely given that rural areas normally face a competitive disadvantage vis-à-vis urban areas in the production of such goods.

supplies enable the growth of downstream activities, in particular agro-processing and marketing services. Agricultural development also generates increased saving surpluses, which can be channelled to rural non-farm activities by farming households or the financial system. Labour flows between the agricultural and non-agricultural sectors are less predictable and dependent on whether the agricultural transformation releases or absorbs labour. The latter scenario sometimes characterises the initial stages of agricultural intensification.

Demand dynamics arising from agricultural growth are equally – if not more – significant. Agriculture stands out as the most obvious activity with potential to increase rural incomes due to the sheer number of people directly involved in this activity and its production linkages. Rising agricultural incomes thus generate demand for agricultural inputs and support services and for consumer goods and services. Consumption linkages typically outweigh production linkages, and the gap between the two is particularly high during the initial phases of agricultural transformation.

Hence, agricultural development normally generates a virtuous cycle, in which the expansion of agriculture fuels non-farm sector growth, and vice-versa. The relative importance of rural non-farm employment may either increase or decline during the initial stages of agricultural development, depending on changes in the intensity of labour use in agriculture as it modernises. The impact of agricultural growth on the local non-farm sector also depends on the strength of supply and demand linkages within a particular region. These linkages are critically determined by land distribution patterns; the share of local agricultural produce processed within production areas; the intensity of input use in agriculture; the proportion of local savings that are channelled to investment within the region; and the local component of consumer demand.

Moreover, the distributional impact of this process and its consequences in terms of spatial development should be well understood. Changes in demand patterns arising from agricultural development benefits those who are able to respond to emerging needs but hurts producers who cannot adapt to the new market environment. For example, suppliers of traditional implements may lose market share as agriculture mechanises while local manufacturers may suffer if increased incomes bring about shifts in consumption patterns towards modern manufactures imported from outside areas. There may also be losers as a consequence of changing employment patterns in agriculture, especially if agricultural modernisation reduces the intensity of labour use in farming and if those displaced fail to enter activities enjoying growing demand. Finally, it is likely that many of the activities which expand as a result of agricultural growth, such as input supply and food processing, will be disproportionately located in rural towns. In contexts where women are not traditionally engaged in such activities or face mobility barriers, the process of agricultural transformation may be accompanied by increasing gender inequalities.

In most case study regions, there is little evidence of agricultural development driving local economic growth in a significant manner, and this largely explains why incomes remain so low, poverty so endemic, and migration so widespread in these regions. The underlying reasons behind limited agricultural development vary from place to place. Poor natural resource endowments, as in the mountainous regions of Armenia (Kharatyan and Janowski, 2002) and the drought-prone areas of eastern Orissa (Rath *et al*, 2002), is certainly a major factor. Irrigation infrastructure is insufficiently developed in these regions, thereby failing to compensate for adverse agro-climatic conditions. In contrast, parts of Romania and Georgia are endowed with good agricultural land, and other reasons explain the poor performance of their agricultural sector.

In post-socialist economies the disruption to input supply systems, agricultural production services, marketing chains and agro-processing activities since the start of transition has led to a generalised retreat into semi-subsistence farming (Kharatyan and Janowski, 2002; Janowski and Bleahu, 2001). This process was also associated with the fragmentation of landholdings following the implementation of agrarian reform programmes in the early 1990s, whereby land under state and collective explorations was distributed among the rural population, who had no previous experience of managing a farming business and generally lacked the means to develop such activity on a commercial basis ((Kharatyan and Janowski, 2002; Janowski and Bleahu, 2001). Unless the decline in agricultural marketed production and the weakening of upstream and downstream production linkages are reversed, prospects for rural income growth will remain bleak.

In Uganda, despite the gradual commercialisation of agriculture, less than one-third of food production is marketed while input use and local processing remains limited (Smith, 2002; Zwick, 2001). Farming is the main economic activity for approximately 85 percent of rural households. Given the very low household income levels in rural Uganda, up to 60 percent of total expenditure is spent on food (Smith, 2002). A continued expansion and intensification of agricultural production over the coming decades, and the consequent development of support activities and agro-processing, will be required for broad-based growth in rural areas and a significant expansion of local markets for non-farm products and services.

Agriculture is by far the dominant economic activity in rural Orissa and Madhya Pradesh. Unlike Punjab and Haryana, however, these two Indian states have not been much affected by the Green Revolution and the related process of agricultural commercialisation. Still, in Madhya Pradesh there is evidence pointing towards the more recent and gradual agricultural intensification in certain areas having an impact upon the development of a number of dependent non-farm activities, such as input supply and repair activities (Som *et al*, 2002). However, in some communities, a very unequal land ownership system[10] and the adoption of labour-saving technologies was seen as reducing the consumption linkages associated with agricultural income growth. Women are also at a disadvantage since they are not engaged in many of the activities which are expanding as a result of agricultural modernisation, including transport, input supply and mechanical repairs.

2.3 Natural resource endowments

The research here reviewed shows that the development of the non-farm sector in a particular region is intimately dependent on its natural resource endowments. In all studied regions, a significant proportion of rural non-farm economic activity is directly linked to the natural resource base. Apart from agriculture-linked activities, which were discussed above, the non-farm sector comprises wood processing and trading, alcohol production, fish processing and trading, mining and quarrying, handicraft production, carpentry, construction and tourism. Hence, in most contexts, favourable natural resource endowments are a necessary, albeit not sufficient, condition for the development of the non-farm sector and the rural economy in general.

[10] Land distribution is equally skewed in Orissa (Pandey *et* al, 2002; Rath *et al*, 2002).

2.4 Economic infrastructure

Economic infrastructure shapes the development of the RNFE by influencing the scope for developing certain economic activities, the operational costs faced by enterprises, and the conditions for accessing outside markets. In other words, while the comparative advantage of a particular region generally lies in natural resource-based economic activities, and is therefore crucially determined by its natural resource endowments[11], in order for that region to convert its comparative advantage into competitive advantage it needs well developed economic infrastructure[12], including a reasonably dense network of rural towns. The influence of transport infrastructure (and services) is especially important given that income and demand levels within a particular rural area are largely a function of the "export" of goods and services to distant domestic and foreign markets with good absorption capacity and growth prospects.

In Uganda road infrastructure has improved significantly over the past decade, but progress in power and water supply to rural areas has been marginal, and weaknesses in these services remain an important obstacle to an expansion of the non-farm sector, particularly in agro-processing and non-food manufacturing (Cannon and Smith, 2002; Marter, 2002). Interestingly, lack of access to power supply and to fixed telephone lines were not identified as a major constraint by field respondents, presumably because limitations in these spheres are considered normal. The lack of fixed lines in rural areas is largely behind the recent expansion of mobile phone use, but this is relatively expensive and essentially restricted to the wealthier entrepreneurs, namely in the trading sector. Within Uganda, economic infrastructure and public services are particularly under-developed in the northern region.

Data from an enterprise survey conducted in two counties of Romania (Davis and Gaburici, 2001) show that transport links and access to water supply constitute significant obstacles to rural enterprise development, unlike access to power supply and telecommunications, which is generally good. Poor economic infrastructure was considered a key constraint in a similar survey carried out in Armenia (Bezemer and Davis, 2002). Road infrastructure is particularly poor, and its negative impact on access to export markets was severely magnified during the 1990s by the economic blockade imposed on Armenia by Azerbaijan and Turkey and the Georgia-Abkhazian conflict (Kharatyan, 2002).

In the case study districts of India poor road connections were identified as an important marketing constraint in many communities and unreliable power supply as an impediment to the development of agro-processing at the village level (Pandey et al, 2002; Rath et al, 2002; Som et al, 2002).

[11] Clearly, the comparative advantage of rural regions is also influenced by their physical and human capital endowments and by population densities.

[12] An enabling business environment, discussed in sub-section 2.7, is equally important.

2.5 Levels of public services and investment

The presence of the state in a given area can be a significant driver of local income growth. Its relative importance for the development of non-farm economic activity is likely to be greater in poor regions, which typically lack other significant sources of demand. For example, public investment in schools, training centres, health clinics, roads, irrigation systems, and other social and economic infrastructure can provide a major boost to local construction and related activities. Moreover, the development of public administration and services generates salary employment and income, often in areas where such opportunities are lacking, which will partly be spent locally. Some public services, for example in education, may also give rise to linkages with upstream non-farm activities.

In all studied countries the scope for public investment and an expansion of public administration and services is limited by tight budget constraints. Rural areas will generally be at a disadvantage vis-à-vis urban areas due to the common urban bias in the allocation of public expenditure (Lanjouw and Feder, 2001) and the tendency for public resources to be allocated taking population density and economic potential criteria into consideration. Poor areas often score low on both accounts.

In most CEECIS countries government expenditure in rural areas has contracted significantly following radical changes in the role of the state, the prolonged economic decline, and the collapse of tax revenue since the start of transition. Multiple activity in farming and non-farm activities have become common for public sector employees in rural areas due to the abrupt decline in real salaries and salary payment arrears (Kharatyan, 2002; Kobaladze, 2002; Janowski and Bleahu, 2001).

The limited presence of the state in the rural areas of Uganda is reflected in the small number of salaried government employees, who account for only two percent of the rural population (Uganda Bureau of Statistics, 2001). Still, the current policy objective of achieving universal primary education and expanding health service provision in Uganda has had significant impact in the rural non-farm sector (Marter, 2002; Smith, 2002). The expansion of the school and health post networks has created considerable demand for bricks, construction work and furniture, while the dramatic rise in the number of enrolled students has created a need for local provision of uniforms, stationery and snack foods. The on-going decentralisation process has led to increased employment and salary payments in local administration, although envisaged benefits for local economic activity have not yet materialised due to weaknesses in planning and resource allocation (Marter, 2002; Smith, 2002; James *et al*, 2001).

In rural India, government employment and infrastructure development schemes are a source of supplementary income to many poor households and provide some stimulus to local construction activities (Dasgupta *et* al, 2002). Although these programmes cannot be considered as true drivers of local growth, they contribute to sustaining the incomes of relatively poor segments of rural communities. Moreover, given the poor level of economic development in the studied areas, government employment remains one of the few sources of permanent salaried employment (Pandey et al, 2002; Rath et al, 2002; Som et al, 2002).

2.6 Rural town development

Rural towns play multiple economic roles, some of which strengthen local inter-sector linkages and contribute to the development of the RNFE, and therefore the existence of a large number of evenly spread small towns is likely to contribute to the development of the non-farm sector and rural areas in general. Given the concentration of economic activity and population, rural towns may serve as important market outlets for manufactured goods produced within surrounding villages and as employment centres for villagers who commute on a regular basis in order to sell services or their labour. Because these towns tend to attract people from surrounding areas or in transit, they generally host a range of services catering for their needs, including car repair workshops, petrol stations, retail shops, hotels, restaurants and bars. In addition, rural towns offer better conditions than villages for the development of agro-processing industries and other manufacturing activities due to availability of administrative and support services, concentration of consumers, and better access to transport infrastructure, power, water and telecommunications. They also tend to host enterprises dedicated to the manufacturing of agricultural inputs and the provision of essential support services to agricultural and non-farm activities located in the surrounding areas. Finally, rural towns can constitute important links between the rural hinterland and more distant markets, playing the role of intermediate marketing centres.

Clearly, the linkages between town growth and the development of rural non-farm activity are complex and not always positive. By linking the rural hinterland with the wider economy, they may expose the former to competition from the outside, thereby rendering some traditional manufacturing activities non-viable. This process, which has been observed in India (Coppard, 2001), is also associated with changing consumer preferences towards modern substitutes.

As intermediary centres linking their rural hinterland to the wider domestic economy, rural towns reflect economic developments in both spaces. In other words, their formation and growth is intimately dependent on upstream and downstream spatial development dynamics. In poor agrarian societies, such as those in Uganda and some Indian states, rural towns are typically few and small and exhibit relatively weak linkages with surrounding areas (Ashok et al, 2002; Smith, 2002). Studied towns in these two countries are not playing a major role as consumption outlets due to their very small size, neither are they important agro-processing locations. Agro-processing activities are concentrated in larger cities[13], where they benefit from larger concentration of consumers and improved access to economic infrastructure. The fact that none of the studied towns is located in a major grain producing area also explains these patterns. These towns are essentially administrative and service centres. Their role as wholesale points for farm and non-farm "exports" is confined to a few products and less evident than their role as distribution centres for goods imported from the outside. Agricultural input manufacturing in these towns is relatively unimportant but some businesses sell inputs to farmers. Generally, however, studied towns are gradually gaining importance as business and employment locations, especially in the context of service-based enterprise development.

[13] Kampala in Uganda and district capitals in the case study districts of Madhya Pradesh and Orissa.

In Armenia, rural towns and cities are experiencing a major crisis, reflecting the broader and acute economic crisis in the country (Kharatyan, 2002). In the past, many rural towns hosted large-scale industrial and mining enterprises, but most were closed following the withdrawal of state support. Likewise, most rural town enterprises involved in agricultural service provision and agro-processing collapsed following the demise of the co-operative and collective farming sectors. Widespread unemployment, migration abroad and declining urban incomes have significantly reduced the role of these towns as consumption centres, exacerbating the acute marketing problems faced by farmers. Finally, retailing businesses in rural towns were found to sell household items to cash-constrained villagers, thus undermining the viability of village shops, which tend to sell similar products at higher prices. The tendency for rural dwellers to travel to towns in order to procure household items at cheaper prices than those practised in their villages, a symptom of acute cash constraints, was also observed in Georgia (Kobaladze, 2002).

2.7 Business environment

Private sector investment levels and enterprise development in rural areas can be either facilitated or hindered by the business environment, depending on how the latter impacts upon investment risks, entry barriers (including start-up costs) to economic activity, and/or production and marketing costs. Important dimensions of the business environment include the macro-economic situation, degree of policy consistency and stability, direct and indirect taxation regimes, investment and licensing regulations, red-tape levels, labour laws, corruption levels, security situation, effectiveness of the judicial system, state of economic infrastructure, and availability and quality of enterprise support services. While the research projects under review have not explicitly looked at the business environment, they shed some light on this issue. Given that economic infrastructure was already

Despite significant improvements over the past decade, the investment climate in rural Uganda remains relatively adverse. Cannon and Smith (2002) and Marter (2002) identify a number of critical problem areas. Insurgency activities in the south-western and eastern parts of the country ended during the 1990s but they continue significant in the North. Law enforcement is poor and the judicial system structurally weak. Contractual law is deficient, and access by rural entrepreneurs to related judicial services very limited, with negative implications in terms of investment safeguard and the scope for effective resolution of commercial disputes. Corruption in rural areas is widely perceived as significant. Local taxation on the movement of crops is seen as inefficient and detrimental to the development of agricultural marketing. Government efforts to address these problems have so far failed to produce very meaningful results. On a more positive note, the achieved macroeconomic stability, the privatisation of public-owned enterprises, and the liberalisation and deregulation of agricultural marketing have resulted in improved conditions for private sector development in Uganda's rural areas.

The complexity and restrictive nature of the regulatory environment in India impose significant entry barriers and costs to rural business activity (Coppard, 2001; Fisher and Mahajan, 1997). Activities for which the government allocates property rights over primary resources – such as mining and food processing – are heavily regulated whereas other – such as rural construction and most services – enjoy much looser regulatory controls. Regulations are often circumvented by rural producers and used for rent extraction by officials. The examples of activities involving the extraction, marketing and processing of forest products in Madhya Pradesh and Orissa illustrates the regulatory burden imposed on producers and the poor enforcement of regulations (Pandey et al, 2002; Rath et al, 2002; Som et al, 2002).

While acknowledging that liberalisation has reduced the regulatory burden faced by entrepreneurs in many sectors of economic activity, Fisher and Mahajan (1997) argue that further reforms are required to make the regulatory framework simpler and more transparent. This is considered necessary to ensure more equitable participation in economic activity and enhance enterprise profitability and competitiveness. Reforms should comprise regulations on company incorporation and registration, licensing for production and raw materials, taxation, labour wages and welfare, and environmental and consumer protection. Action is required at both national and state level.

The institutional and business environment in the rural areas of post-socialist countries has undergone radical changes over the past decade as a result of the overall transition from a centrally planned to a market economy. The private sector in these countries has a relatively short history, and significant improvements in the investment climate are required to facilitate its development. Key informant interviews at village level revealed that entrepreneurs experience illegal demands for bribes from government inspectors and officials, face high import duties for machinery, and operate in a legal environment that is in permanent change (Janowski and Bleahu, 2001). An enterprise survey carried out in two counties of Romania identified other areas that deserve special consideration (Davis and Gaburici, 2002). Inflation stabilisation and economic recovery were found important to improve enterprise profitability and create a more favourable investment horizon[14]. Deficient legislation on competition, contracts and property rights was identified as another important constraint, with more than half of survey respondents considering it to be poor and ineffective. The cost of undertaking legal action was also found to be very high.

Lack of legal safety was identified as a significant constraint to enterprise development in Armenia (Bezemer and Davis, 2002). Field research moreover shows the difficulties that small rural entrepreneurs have in understanding and complying with a legal framework that is in permanent change (Kharatyan, 2002). In Georgia enterprise survey respondents have highlighted high taxation and corruption as important problems (Davis et al, 2002). Unsurprisingly, rural entrepreneurs in these two countries often avoid connections with state institutions, preferring to remain informal and avoid tax payments. The bankruptcies in the financial sector during the early 1990s are still fresh in the memory of Georgians, many of whom lost part or all of their bank savings as a result. Business support structures, for example in the training and advisory spheres, remain very deficient in both countries.

[14] Currency devaluation and economic recession were both found to undermine the profitability of surveyed firms.

3 Key policy conclusions

3.1 Determinants of access to non-farm employment

Access to non-farm employment is determined by a wide and complex range of factors. These can be categorised into three different types:

1. Characteristics intrinsic to households and their members, including the set of assets owned or available to them. The influence of education levels and skill endowments, land ownership, and access to finance were discussed based on evidence from case study countries and regions. These factors determine the relative ability of households and individuals to exploit existing opportunities in the RNFE. Unequal asset endowments generate inequitable participation patterns, whereby some manage to engage in non-farm activities as part of an accumulation strategy whereas other remain trapped in low return activities.

2. Social institutions and cultural environment. Social and cultural institutions condition the way different households and individuals are able to benefit from available opportunities in the RNFE. Special attention was paid to gender dynamics, social capital, ethnicity and caste. The diversity of social institutions across countries and within specific countries, and their changing nature over time, were emphasised.

3. Wider environment in rural areas. The natural and economic environment influences the RNFE development potential. Special attention was given to on-going processes of agricultural development, natural resource endowments, levels of public investment and service provision, rural town development, economic infrastructure, and the business environment. These factors determine opportunities available to rural economic agents through their impact on local demand levels and patterns and on the comparative and competitive advantage of rural areas and enterprises.

In the studied regions a significant proportion of rural households and entrepreneurs not only lack many of the required assets to successfully engage in non-farm employment, but also operate in a relatively adverse environment, characterised by limited opportunities both within and outside the farm economy. Consequently, in all studied regions diversification into non-farm economic activities out of necessity (distress-push) is more common than diversification as a response to remunerative wage employment and high-return business opportunities (demand-pull).

Unsurprisingly, temporary or permanent out-migration is common – and sometimes widespread – in most case study regions. Migration remittances can constitute a significant source of household income, contributing to the development of the non-farm sector through its impact on local demand levels and available funds for business development. Skills acquired by migrant workers may also prove useful for the development of non-farm activities. However, the significance of these positive effects should not be exaggerated, especially when migration takes place within the country and largely entails unskilled and low paid work, as in the studied regions of India and Uganda. Moreover, in all the case study areas migration represents a drain of critical labour resources for the households involved, while in the three transition economies under review it also diverts much-needed entrepreneurial skills away from rural areas.

3.2 Policy implications

Policies and strategies aimed at improving access to non-farm employment must account for all the three access dimensions outlined above. An excessive emphasis on the individual and household overlooks the critical importance of creating an environment that is conducive to enterprise development. On the other hand, too much attention to economic growth without due consideration to the asset requirements for successful participation in such process may generate inequitable outcomes, in which the benefits from growth are not widely shared amongst the rural population. In such scenario, the trickle down effects of economic growth are limited, and so is its impact on rural development and poverty reduction.

Government action critically determines the prospects for growth of rural non-farm activities and the patterns of participation in the RNFE. The central importance of governments arises largely from their traditional role in the financing and/or provision of pure and semi-public goods such as agricultural research and extension, economic infrastructure, and education and training. The business environment also comprises a wide range of public goods, or public ills, depending on the context. These include law and order, macroeconomic stability, and regulation of economic activity. Finally, governments have important responsibilities in the area of rural town planning.

An active role in most of these spheres is generally conducive to the development of rural non-farm activities, and is therefore desirable. However, excessive intervention in some areas may have undesirable effects. For example, cumbersome regulations that impose stringent restrictions on economic activity may inflict undue costs to rural enterprises. The ability of governments to control the actions of economic agents through regulations is limited and attempts to do so can be ultimately counter-productive.

Likewise, too much interference in the financial sector may fail to solve the typical failure of markets to channel savings effectively and efficiently to productive and profitable rural economic activities, as illustrated by past experiences in India. These observations notwithstanding, the scope for improving the financial sector regulatory environment and enhancing access to credit through group approaches should not be underestimated.

While social institutions and the cultural environment often limit the scope for certain socio-economic groups to successfully engage in remunerative economic activities, the capacity of governments to shape these variables is somewhat limited and far from straightforward. Still, the analysis developed in this report shows the crucial importance of incorporating a gender dimension – and caste dimension in the case of India – into public policy and investment programmes. This must be informed by detailed knowledge of local realities and a long-term perspective must be adopted. Another area where appropriate intervention can prove effective is the promotion of group approaches to credit and enterprise development. These have the potential to build social capital between group members and between these and other market players and service providers. Groups can also be an effective strategy for targeting and empowering women.

A balance must be reached with respect to villages and towns as entry points for RNFE policy and programme interventions. Although interventions at village level can prove important, in most contexts special attention should be accorded to towns as focal points. Firstly, while the majority of the rural population in the developing world lives in villages, a significant proportion of the non-farm economic activity is concentrated in small and medium-size rural towns. Secondly, these towns play a strategic role in the provision of production and marketing services to non-farm activities carried out at village level, as well as constituting critical market outlets for village-level producers and important employment centres for village residents. Thirdly, the greatest potential for RNFE development often lies in rural town centres. Finally, because of the scattered location of villages, interventions within rural towns are often superior from a cost-effectiveness viewpoint.

It is equally important to consider the cost-effectiveness of interventions in high potential vis-à-vis low potential areas. For example, the impact of an expansion of the power supply network and improvements in road infrastructure will be greater if channelled to regions with considerable potential for enterprise development and relatively high population densities. In contrast, in regions lacking potential to develop agriculture and other sizeable economic activities, investment in transport infrastructure may generate some benefits but at the same time hurt producers who become more exposed to outside competition.

As the research reviewed in this study shows, there is no single *"magic bullet"* for enhancing participation in the RNFE. Much attention has been devoted to credit delivery and technical training provision as strategies to enable the poor to develop income-generating activities, but the limitations of narrow approaches have been validated in a wide range of contexts. In other words, holistic approaches are required to address the multi-faceted constraints and complex needs faced by rural households in accessing self and wage employment opportunities.

Finally, the NRI studies confirm the crucial importance of agriculture for the development of the rural non-farm sector. The fortunes of the two sectors are intimately intertwined. Consequently, interventions targeting specific sub-sectors should develop hand-in-hand with a more holistic view of rural development.

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