

NRI Report No: 2767

Small Towns and Local Economic Development in Four Districts of Madhya Pradesh and Orissa, India.

by

Wandschneider, T

The views expressed in this report are solely those of the author and not necessarily those of DFID or the World Bank



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INTRODUCTION

Background

This study forms part of a research project concerned with improved understanding of the rural non-farm economy in India and policies that enhance its contribution to livelihoods and poverty reduction. The research was undertaken by the Natural Resources Institute (NRI) and local partners, with funding from the United Kingdom's Department for International Development (DFID) under a collaborative rural development programme with the World Bank. Special emphasis was given to factors enabling access to non-farm employment and income opportunities and the links between local governance and the development of the rural non-farm economy. The research was conducted in four districts of Madhya Pradesh and Orissa, two of India's poorest states.

Whilst much of the research under this project focused on village level issues, it is recognised that towns with a population under 50,000 or even 100,000 inhabitants, and surrounded by a rural hinterland, form an integral part of the rural economy. Much economic activity in these small urban centres is closely linked to the village economy through consumption, production and financial linkages. Furthermore, village households depend on and interact with local towns in the pursuit of livelihood strategies and activities. Consequently, such locations often offer an appropriate entry point for public investment and policy interventions targeted at rural areas.

These inter-dependencies are well established in the literature on rural-urban linkages (Satterthwaite, 2000; Douglass, 1998). Small and dispersed urban centres tend to benefit from growth of the surrounding village economy, through an increase in the demand for goods and services and the surplus available for processing and/or marketing. At the same time, small rural towns can be instrumental in stimulating and sustaining an expansion of economic activity and incomes in their rural hinterland. Their potential role as input distribution, financial service provision, agricultural processing, and employment centres is noteworthy. They can also serve as important market outlets for locally produced goods and link village producers to wider markets.

Yet, the linkages between local towns and their rural hinterland may be weak and not always mutually beneficial (Satterthwaite, 2000; Douglass, 1998; Tacoli, 1998; Hardoy and Satterthwaite, 1986). For example, commodity flows from rural to urban areas may by-pass local towns. Moreover, by acting as distribution points for imported goods, these locations may expose local producers to outside competition, whilst as financial centres they may divert rural savings to outside areas. Finally, disadvantaged groups in village communities may benefit little from proximity to small urban centres due to lack of productive assets and social barriers to participation in economic activity. Rural-urban linkages are shaped by policies and institutions at the macro, meso and sector level and the local social and economic structure. These factors critically influence development dynamics at village and town level and the type of economic interaction between both spaces.

This study aims to improve understanding of the scale and nature of inter-dependencies between small towns and their rural hinterland, and to derive relevant policy implications. It was conducted in two districts of Madhya Pradesh (Betul and Narsimhpur) and two districts of Orissa (Bolangir and Nayagarh). The focus is on

block headquarter towns¹, the lowest level locations within the urban hierarchy in India, since it is at this level that interaction between the village and urban economies is most regular and intense (Wandschneider and Mishra, 2003).

Methodological issues

Fieldwork was conducted in six towns. Given the limited time and resources available to carry out the study, it was decided to structure the survey around the enterprise sector. An understanding of enterprise activity in small rural towns provides critical insight into the nature and extent of spatial economic linkages and public policy and investment interventions with potential to stimulate local economic development. Information was collected on the type of enterprise activity, interaction with input suppliers and customers, and employment patterns. Entrepreneurs and enterprise managers were also asked about the factors which have enabled and constrained business development, as well as business support service needs.

In total, 183 structured interviews were carried out with enterprise owners and managers (Table 1). This was complemented by 30 semi-structured interviews with key informants in the enterprise and government sectors, through which specific issues (e.g. credit, taxation, regulations, services, infrastructure and opportunities) were discussed in more detail. Despite its small size, the sample provides a good representation of the spectrum of enterprise activity in the study locations, and comprises a large proportion of existing enterprises in key sectors, such as agro-processing. Indeed, although enterprises were randomly selected, there was an explicit attempt to cover all the major private sector activities found in the study locations. Cirrus Management Services (CMS) implemented the survey in collaboration with local NGOs² and contributed to data processing and analysis.

Table 1 – Number of interviews

State	Town	District	Structured interviews	Unstructured interviews
Madhya Pradesh	Gotegaon	Narshimpur	35	7
	Chichli	Narshimpur	13	0
	Betul	Betul	35	5
Orissa	Patnagarh	Bolangir	34	8
	Daspalla	Nayagarh	34	5
	Odagaon	Nayagarh	32	5
Total			183	30

The study illustrates the usefulness of enterprise surveys as a tool for understanding local economic development patterns, constraints to enterprise development, and public policy and investment gaps. Future surveys could be refined and extended to other locations along the urban hierarchy. This could be complemented by village studies to gain improved insight into distributional issues and the level and purpose of

¹ Districts are divided into community development blocks for administrative purposes, the delivery of public services, and the execution of local development programmes. Each block has its own headquarters.

² Debate and Samarthan participated in the fieldwork in Madhya Pradesh, while Action Aid and the Centre for Youth and Social Development (CYSD) assisted the research team in Orissa.

interaction between villagers and rural towns, for example. The village and urban perspectives could also be combined in sub-sector studies, which offer an interesting analytical tool for identifying drivers of local economic growth, tracking spatial commodity flows, assessing the distribution of benefits along supply chains, understanding constraints and opportunities, and determining critical entry points for policy and investment interventions. Finally, there is a need for in-depth policy analysis, which requires an historical perspective on the political economy of policy-making and a sound understanding of the institutions and actors, both in the public and private sector, which can initiate and sustain change at the local, regional and national level.

The study locations

The six study locations differ in terms of size (Table 2). Betul is by far the largest settlement, which is unsurprising given its district headquarters status. Although all the other locations are block headquarters, their population varies considerably, from less than 10,000 inhabitants to nearly 25,000 inhabitants. There is also considerable variation in terms of distance to larger towns and cities (Table 2).

Table 2 – Population and location of study towns

Town	District	Town population	Distance to district headquarters	Distance to State Capital
		2001	Km	Km
Betul	Betul	83,485	0	180
Gotegaon	Narsimhpur	23,417	31	231
Chichli	Narsimhpur	9,250	68	175
Patnagarh	Balangir	18,685	38	418
Daspalla	Nayagarh	< 10,000	40	290
Odagoan	Nayagarh	< 10,000	26	276

Source: Census of India (2001)

The surveyed towns are located in districts that are predominantly rural (Table 3). With less than 5 percent of its population residing in urban centres, Nayagarh has the lowest urbanisation rate, not only among the four districts but also in the whole of Orissa State. Betul has the highest urbanisation rate, with nearly 19 percent of its population living in six urban centres. With the exception of Betul, over the past decade the urban population has increased at a much faster rate than the rural population. The difference between urban and rural population growth was especially pronounced in Bolangir and Nayagarh, where overall population growth was lowest. This is an indication of permanent out-migration from rural areas to local towns and other districts.

According to Indian statistical definitions, two of the study locations (Daspalla and Odagoan) are considered rural. Urban centres are defined as statutory towns and all other places which have a minimum of 5,000 residents, at least 75% of the male working population engaged in non-agricultural and allied activities, and a population density of at least 400 persons per square km. Population data for these two locations are not available, and therefore it is not known under which criteria they fail to qualify as urban locations.

Table 3 – Urban and rural population growth at district level

District	District population	Number of towns	Urbanisation rate	Percentage decadal growth of urban population 1991-2001	Percentage decadal growth of rural population 1991-2001
Betul	1,394,421	6	18.6	17.7	18.1
Narsimhpur	957,399	5	16	31.1	20.3
Bolangir	1,335,760	4	11.6	19.2	7.3
Nayagarh	826,882	1	4.3	41.2	9.3

Source: Census of India (2001)

Agriculture constitutes the main source of rural livelihoods in the study areas but there is significant variation with regards to the main crops grown locally. Non-timber forest produce also provides an important source of income to those living in forest areas. With the exception of Betul, which has an industrial area situated in Betul town, none of the other blocks has significant modern manufacturing industry. Each block specialises in specific traditional manufacturing activities. For example, hand looming is historically a significant activity in Patnagarh and brass metal making is important in Chichli, while Odagoan is renowned for its stone carving industry.

SECTION I

PROFILE OF SMALL TOWN ENTERPRISES

Sectors of activity

The enterprise sample (Table 4) reflects the relative importance of different economic activities in the six surveyed towns. Services (including trade and transport) constitute by far the main area of enterprise activity. Retailing of food and other consumables is particularly widespread. Other commonly found private service activities include wholesale trading of agricultural produce and manufactured items, restaurants, food stalls, hotels, motorised and non-motorised transport, and mechanical repairs. The dominance of services in the town economy is even more pronounced than suggested by the data since the survey did not include public services such as administration, police, health and education.

Some traditional and modern manufacturing firms are also present in the six study towns. Although the range of manufacturing activity tends to be fairly restricted, in some locations there are a significant number of units operating in specific, often caste-based traditional activities. For example, there are over 50 leather shoe producers in Daspalla, approximately 70 stone carving artisans in Odagoan, about 25 jewellery makers in Patnagarh, and a similar number of brass utensil makers and cobblers in Chichli. Many jewellers and cobblers can also be found in Gotegaon and Betul.

Table 4 – Distribution of sample enterprises across sectors

	No. of enterprises	Type of activities
Agricultural and food processing	7	Rice, dal and flour mills
Mining, manufacturing and construction	42	Manufacturing of agricultural implements and equipment, brass making, jewellery making, leather shoe manufacturing, pottery, carpet weaving, tailoring, saw mills, carpentry
Services	134	Pan shop, grocery shop, restaurant, tea shop, hotel, chemist, book seller, cloth shop, sambalpuri saree shop, hardware shop, agricultural equipment dealer, agro-chemical dealer, grain trading, internet centre, computer institute, bicycle and mechanical repairs, motorised and non-motorised transport
Total	183	

Source: Fieldwork, July 2002

Surprisingly, there is limited agro-processing at town level, even though agriculture remains by far the main livelihood activity in surrounding areas. It is striking that no agricultural processing enterprise was found in half of the study locations. In Patnagarh there is only one flour mill and one rice mill. Several *dal* mills, one *dal* cleaning unit, and one flour processing firm are based in Gotegaon. *Dal* milling is

equally important in Betul, which also hosts one dairy enterprise and soya oil, flour and *rava* mills.

Ownership structure

All but two of the sample enterprises are permanent, full-time businesses. Most are owned by an individual, although a few cases of unregistered partnerships, generally confined to extended families, were also found. More sophisticated forms of ownership – for example registered partnerships and limited liability companies – are rare. Such types of proprietorship are not only more complex to set up and manage, but also require higher levels of interface with government institutions.

Size

Survey data show that the enterprise landscape is dominated by micro and small units, even if some degree of under-reporting of capital and turnover is accounted for (see tables 5 to 7). Most entrepreneurs invest less than US\$5,000³ to initiate their business activity. Annual turnover typically varies between US\$1,000 and US\$10,000. Each enterprise employs on average six workers, but in more than half of the cases the workforce consists of less than two workers, often family members. The largest firms can be found in activities such as agro-processing, building or road construction, brick making, motorised transport and grain wholesaling. A soya oil and flour mill in Betul town is at the very top of the enterprise spectrum, with a workforce of 250 and an annual turnover in excess of US\$3 million.

The scale of enterprise activity is largest in Gotegaon and Betul. In the former case, this reflects a relatively more prosperous local agricultural economy, leading to greater availability and lower cost of raw materials for processing and marketing, as well as higher demand for goods and services produced or sold within local towns. In the specific case of Betul, the considerably larger size of its population and higher purchasing power generates significant demand for a variety of goods and services within the town itself. Finally, the fact that both locations benefit from relatively good transport links enables some firms to expand their market outreach to a greater extent than those in the other study towns.

Age

Although some businesses have been running for several decades and many have been active for more than 15 years, nearly half of the enterprises have been established after 1995. Such a high proportion of recently formed firms is largely a consequence of limited wage and salaried employment opportunities. Unable to find a remunerative job in government or the private sector, many town dwellers turn to business in order to earn a living. Low agricultural incomes also compel people to diversify into non-farm activities. Still, some enterprises have emerged in response to expanding market opportunities, as in the case of jewellery units in Patnagarh and leather shoe manufacturing workshops in Daspalla.

³ At the time of the survey, one US dollar was equivalent to 46 Rupees.

Table 5 – Start-up capital of rural town enterprises (% of firms)

	< 50,000 Rps	50,000 – 250,000 Rps	250,000 – 500,000 Rps	500,000 – 1,000,000 Rps	> 1,000,000 Rps
Agricultural and food processing (N = 7)	14.3	0	0	14.3	71.4
Mining, manufacturing and construction (N = 42)	59.5	21.4	9.5	4.8	4.8
Services (N = 134)	56	40.3	2.2	1.5	0
Total (N = 183)	55.2	34.4	3.8	2.8	3.8

Source: Questionnaire survey, July 2002

Table 6 – Annual turnover of rural town enterprises (% of firms)

	< 50,000 Rps	50,000 – 250,000 Rps	250,000 – 500,000 Rps	500,000 – 1,000,000 Rps	1,000,000 – 2,000,000 Rps	> 2,000,000 Rps
Agricultural and food processing (N = 7)	0	14.3	0	0	14.3	71.4
Mining, manufacturing and construction (N = 42)	16.7	45.2	9.5	2.4	9.5	16.7
Services (N = 134)	7.5	50	16.4	12.7	6	7.4
Total (N = 183)	9.3	47.5	14.2	9.9	7.5	11.6

Source: Questionnaire survey, July 2002

Table 7 – Employment in rural town enterprises

	Total number of workers	Average number of workers	Number of workers (% of enterprises)				
			0 – 2	3 – 4	5 – 10	11 – 20	> 20
Agricultural and food processing (N = 7)	357	51	0	0	28.6	28.6	42.9
Mining, manufacturing and construction (N = 42)	302	7	40.5	21.4	23.8	9.5	4.8
Services (N = 134)	446	3	63.4	20.9	11.9	2.2	1.5
Total (N = 183)	1,105	6	55.7	20.3	15.3	4.9	3.8

Source: Questionnaire survey, July 2002

Enterprise formation is especially high in the overcrowded retailing sector, where profits are reported to be declining due to increased competition. Low entry and exit barriers as a result of limited capital and skill requirements explain the higher rate of new businesses in this sector. Small-scale traditional manufacturing activities also entail low investment, thereby attracting a significant number of entrepreneurs, with skills often being passed on within the family from one generation to the other. Activities with higher investment thresholds and management skill requirements, and which take longer to break even or involve greater degree of risk-taking, as in the case of medium and large scale agro-processing, are beyond the capacity of most entrepreneurs.

Although it is difficult to ascertain the rate of enterprise mortality, several cases of business closure were reported. The agricultural processing sector seems to be one of the most affected due to problems in accessing good quality produce, relatively low levels of local demand, difficulties in accessing distant markets, and competition from outside sources of supply. A combination of these factors has led to the closure of seven of the eleven *dal* mills in Odagaon over the past few years. In Betul and Chichli three sugar mills have also closed in the recent past. Most sugar cane that is still produced within these blocks is now channelled to sugar mills in Maharashtra and Chattisgarh states.

Access to basic utilities

Given the characteristics of enterprise activity in the surveyed towns, it is not surprising that less than half have a telephone and that only one in ten have access to piped water (Table 8). Even though over 75 percent of the enterprises are connected to the electricity grid, economic activity is significantly disrupted by daily power cuts that may last for four to six hours. Agricultural processing and manufacturing activities are disproportionately affected by constant power cuts.

Table 8 – Access to electricity, telephone and water (% of firms)

	Access to basic utilities		
	Electricity %	Telephone %	Water %
Agricultural and food processing (N = 7)	100	86	14
Mining, manufacturing and construction (N = 42)	88	43	10
Services (N = 134)	72	42	10
Total (N = 183)	78	44	10

Source: Questionnaire survey, July 2002

SECTION II

PROFILE OF SMALL TOWN ENTREPRENEURS

Gender

There is a clear gender pattern in the ownership of rural town enterprises (Table 9). Only one of the surveyed businesses, a beauty parlour, was owned and managed by a woman. The fact that men control enterprise activity reflects acute cultural barriers and clearly defined gender roles in the domestic and economic sphere, which prevent women from venturing into full-time business activities. Women belonging to upper strata families hardly ever become involved in income generating activities, whereas lower caste women contribute to household economic activities and engage in low-paid occupations, often on a seasonal and/or part-time basis, but seldom take on a managerial role in enterprises.

Table 9 – Age, education and gender of rural town entrepreneurs

	Profile of entrepreneurs			
	Average age	Average years of education	Men	Women
Agricultural and food processing (N = 7)	36	16	7	0
Mining, manufacturing and construction (N = 42)	37	13	42	0
Services (N = 134)	35	12	133	1
Total (N = 183)	35	12	182	1

Source: Questionnaire survey, July 2002

Caste

Whilst most entrepreneurs in the surveyed localities are Hindu, in towns such as Betul and Gotegaon it is not uncommon to find Jains, Sikhs and Muslims well established in specific occupations (Table 10). For example, Jains are prominent in grain and non-timber forest produce trading whereas Muslims are often involved in machinery repairs. The participation of individuals belonging to scheduled castes and scheduled tribes in the running of enterprises is very limited and well below their representation in the population, signalling acute caste-based inequalities in asset distribution and access to economic opportunities. Entrepreneurs belonging to scheduled castes are usually active in traditional, caste-defined occupations such as the manufacturing of brass, copper and leather articles.

Table 10 – Caste/religion of rural town entrepreneurs

	General Caste	Caste/Religion (%)						
		Hindu OBC*	SC**	ST***	Sikh	Muslim	Jain	Buddhist
Agricultural and food processing (N = 7)	71.4	0	0	0	0	0	28.6	0
Mining, manufacturing and construction (N = 42)	26.2	19	14.3	0	7.1	7.1	7.1	0
Services (N = 134)	29.9	32.1	3.7	0.7	1.5	5.2	10.4	0.7
Total (N = 183)	30.6	27.9	6	0.5	2.7	5.5	10.4	0.5

* Other backward castes ** Scheduled castes *** Scheduled tribes

Source: Questionnaire survey, July 2002

Skills

The average small town entrepreneur is a reasonably well educated male, typically in his thirties or forties. Formal education levels tend to rise with the technology and capital employed, suggesting that education is positively correlated with the value of assets owned by the entrepreneur and his risk-taking ability.

Many entrepreneurs have benefited from on-the-job training as employees. This has allowed them to learn basic technical skills and gain an understanding of other important aspects of the activity before setting up their own businesses. Fewer have received formal vocational training, which is normally sponsored by government agencies, such as the District Industrial Centres (DIC) and the Khadi and Village Industries Commission (KVIC). The informal and formal training received was considered useful by almost all respondents, but it rarely resulted in the transfer of skills in areas such as marketing and management.

Land ownership

Over one third of the surveyed rural town entrepreneurs own land (Table 11). Average landholding size within this group exceeds 10 hectares, which is relatively high in the local context, although this figure is distorted by one respondent in the agricultural processing sector who owns 261.5 hectares. In the manufacturing and service sectors, the holding size for land-owning entrepreneurs averages 6 hectares, which is still well above the local average. Interestingly, while for most land-owning entrepreneurs agriculture is a subsidiary activity carried out on a seasonal and part-time basis, some do not engage in farming at all. This seems to indicate that diversification into non-farm enterprise in small towns can constitute a superior alternative to farming. The fact that few landless entrepreneurs become involved in agriculture by leasing land or as seasonal wage labourers is also noteworthy, which suggests that such options are inferior to running a small town enterprise.

Table 11 – Landholding patterns

	Entrepreneurs that own land %	Average landholding size*		
		Irrigated Ha	Non- irrigated Ha	Total Ha
Agricultural and food processing (N=7)	29	70.9	34.4	105.3
Mining, manufacturing and construction (N=42)	33	3.3	2.8	6.1
Services (N=134)	38	2.3	3.6	5.9
Total (N=183)	36	5.6	4.8	10.4

* Average landholding size is calculated only for those entrepreneurs who own land.

Source: Questionnaire survey, July 2002

SECTION III
LINKAGES BETWEEN SMALL TOWNS AND THE LOCAL VILLAGE ECONOMY

Financial linkages between rural town enterprises and agriculture

The evidence gathered suggests that the direct financial linkages between rural town firms and agriculture are relatively weak. Only 12 percent of the entrepreneurs interviewed reported investing part of their business profits in agriculture, a much lower proportion than those who own land, which reinforces the view that farming is a relatively low-return, unattractive economic activity. However, further work would be required to gain additional insight into financial resource flows between rural towns and the village economy. An issue that merits special consideration is the extent to which land ownership and profits from agriculture have enabled entrepreneurs to successfully diversify into non-farm activities. The financial intermediation role of local banks constitutes another interesting area for research.

Table 12 – Financial flows between rural town enterprises and agriculture

	Entrepreneurs channelling business profits into agriculture
	%
Agricultural and food processing (N = 7)	29
Mining, manufacturing and construction (N = 42)	12
Services (N = 134)	11
Total (N = 183)	12

* Average landholding size is calculated only for those entrepreneurs that own land.

Source: Questionnaire survey, July 2002

Small towns as employment centres

As discussed previously, most businesses in the six study towns absorb little labour due to their very small scale. In addition, a significant majority of the workforce is recruited within the town itself, with most of the remaining workers coming from nearby towns (Table 13). Consequently, very limited wage employment opportunities are generated for village households, with less than three percent of the workforce residing in neighbouring or more distant villages. The recruitment of labour outside the town is heavily concentrated in the few firms employing over 15 workers. For example, one single large firm in our sample employs nearly half of the workforce that commutes from other towns.

The most striking feature of spatial employment patterns lies in the disparity between the number of workers commuting from other towns and from neighbouring villages. Such discrepancy is partly due to differences in access to transport. Unlike towns, villages tend to lack access to regular, nearby transport services, making it difficult for residents to engage in wage employment that entails daily commuting. Another important reason has to do with differences regarding the degree of specialisation on non-farm activities. Villagers tend to rely on farm employment and income to a much greater extent than town dwellers, and are thereby less able to undertake part-time or full-time employment in town enterprises.

Table 13 – Place of residence of the workforce

	Place of residence of the workforce				
	Within town	Another town within 15 km	Another town over 15 km	Village within 15 km	Village over 15 km
	%	%	%	%	%
Agricultural and food processing (N = 7)	43.7	54.1	0.8	1.1	1.1
Mining, manufacturing and construction (N = 42)	81.5	10.3	3.3	0	5
Services (N = 134)	82.3	17.3	0	0	1.3
Total (N = 183)	69.6	27.2	1.2	0.4	2.3

Source: Questionnaire survey, July 2002

Table 14 – Location of rural town input suppliers

	Location of input suppliers					
	Within town	Village within 25 km	Village over 25 km	Town or city within 50 km	Town or city over 50 km	Outside India
	%	%	%	%	%	%
Agricultural and food processing (N = 7)	86	86	57	57	86	0
Mining, manufacturing and construction (N = 42)	55	5	5	33	57	0
Services (N = 134)	43	23	2	31	53	0
Total (N = 183)	48	22	5	33	56	0

Source: Questionnaire survey, July 2002

Table 15 – Location of rural town enterprise clients

	Location of clients					
	Within town	Villages within 25 km	Village over 25 km	Town or city within 50 km	Town or city over 50 km	Outside India
	%	%	%	%	%	%
Agricultural and food processing (N = 7)	43	29	86	29	86	14.3
Mining, manufacturing and construction (N = 42)	86	74	17	19	31	0
Services (N = 134)	97	83	13	9	10	0
Total (N = 183)	93	79	15	12	17	0.5

Source: Questionnaire survey, July 2002

It must be stressed, however, that further work is required to understand more fully the role of local towns in employment generation. For example, the enterprise survey did not assess the structure of wage employment according to gender. The survey may have also failed to capture differences across seasons. For instance, a closer look into employment patterns during the lean agricultural season could have generated a more balanced picture regarding the importance of local towns as employment centres. It is likely that some small rural towns may provide an avenue for seasonal and often casual or part-time self-employment in activities such as construction, rickshaw pulling, and petty trading.

Small towns as market outlets

Small rural towns constitute an important market outlet for local village producers (Table 14). More than one-fifth of the enterprise units surveyed purchase inputs from village households living within 25 kilometres from town. In addition, nearly half buy inputs within the town itself, and these are often produced in nearby villages. A recent study conducted in Bolangir district (Wandschneider and Mishra, 2003) confirms the significance of block headquarters as markets for local village production.

Most village goods channelled to small rural towns consist of agricultural produce which is sold to agro-processing firms, wholesale traders and food retailers. Villagers seldom supply inputs to town-based manufacturing enterprises, but in certain areas they may sell considerable volumes of a limited range of traditional manufactured items to wholesaling and retailing firms. For example, cloth traders and one co-operative society in Patnagarh buy *sambalpuri sarees* and *lungi* from village handloom weavers; several traders in Daspalla procure leaf plates and cups from households living in nearby forest areas; and businessmen in Chichli town contract out production of brass utensils to village artisans.

Small towns as intermediary market centres

The impact of small rural towns upon local production patterns and income levels depends largely on the extent to which they mediate between village producers and non-local sources of demand. These locations are often too small to constitute significant final destination markets for goods produced in their vicinity, and while they also act as local distribution centres, channelling goods and services to nearby villages, the areas serviced tend to be relatively small and characterised by high poverty levels. Hence the strategic importance of non-local, especially urban, markets.

Unsurprisingly, product flows from villages to study towns are particularly significant for goods that are subsequently exported to distant markets. For example, the volumes of pulses and grains channelled to Gotegaon are significant because this location is a relatively important regional market centre for such commodities and hosts a number of processing and wholesaling firms which supply outside markets. Betul absorbs substantial soya and milk volumes due to the presence of a large oil processing unit and a dairy co-operative, both of which cater for distant markets. Weavers in Patnagarh block channel a considerable proportion of their *sambalpuri saree* production to the headquarters town because of its links to markets within and outside Orissa. Some marketing agents in Daspalla channel leaf plates and cups from surrounding villages to market outlets in the coastal districts of Orissa and Bhubaneswar, the state capital. Finally, over 20 businesses in Chichli are involved in

the sale of locally manufactured brass utensils as a result of their well-established position as suppliers to different towns and cities within Madhya Pradesh (e.g. Betul, Seoni, Sagar, Indore and Mirzapur).

Despite these examples, data on client location (Table 15) reveal that rural town enterprises in the study areas are much more reliant on local than outside markets. Over 90 percent of surveyed firms sell goods and services to customers living within town and nearly 80 percent supply customers from villages within 25 kilometres. In contrast, the proportion of businesses selling to clients in towns and cities located at more than 50 kilometres distance is only 17 percent, and many of them have limited or no backward production linkages to the local village economy. For instance, Betul town hosts a range of industries linked to the regional and national economy for both input purchases and product sales. Manufacturing activities in the other towns (e.g. leather shoe and carpet making in Daspalla and jewellery making in Patnagarh) are also integrated into wider market networks for both inputs and outputs. Motorised transport businesses typically have a customer base beyond the local area while construction firms often undertake work in other blocks within the district.

The survey further reveals that little value is added at town level to village production that is channelled to outside markets. While some agricultural processing takes place in Betul, Gotegaon and Patnagarh, such activity is either marginal or non-existent in the other three study towns. Moreover, most locally available resources are processed at village level through the use of very simple technologies (e.g. bamboo and *sal* leaves), transformed outside the block or district (e.g. minor non-timber forest produce), or left unexploited (e.g. medicinal plants).

Finally, key informant views indicate that town entrepreneurs are not channelling critical market information and technologies back to village producers, and thus fail to act as innovation catalysts in key sub-sectors of the local economy, many of which are facing declining returns and difficulties in competing in an increasingly integrated domestic market. For example, *sambalpuri saree* retailers in Patnagarh supply a very limited range of designs to traditional weavers. Contractors of brass utensils in Chichli have neither the capital nor the required skills and marketing contacts to promote diversification towards decorative items and ornaments. In Daspalla block, the government has been promoting a shift to mechanical stitching among women involved in leaf plate making, but very little product innovation is taking place, through the introduction of decorative stitches for example.

In sum, the surveyed towns are playing a relatively limited role in linking the village economy to downstream markets. Structured and semi-structured interviews with local entrepreneurs and government officials suggest that a combination of external factors is partly responsible for this situation. Frequent and prolonged power cuts undermine the development of agro-processing activities at town level. Poor road links raise input procurement and output marketing costs, negatively affecting the competitiveness of activities which depend on availability of cheap local inputs and access to outside markets. Poor access to credit for investment and working capital purposes limits the scope for enterprise expansion.

A weak entrepreneurial base also limits the potential role of rural towns as intermediary market centres. Most entrepreneurs lack marketing and managerial skills. They have inadequate information on market trends and requirements, poorly

developed contacts with distant buyers, and insufficient knowledge of new technologies and products. The degree of informality in enterprise operations is high and the ability to develop business plans limited. The significance of these features as barriers to successful mobilisation of loans from the banking sector cannot be overemphasised.

These considerations notwithstanding, it is important to acknowledge that the rural town and its enterprise sector do not evolve in isolation from developments in the hinterland economy and other urban locations. Rather, their growth mirrors to a large extent what is happening around them. For example, a weak local agricultural base undermines the development of a strong agribusiness sector supplying inputs and services to farmers, processing their produce, and marketing it beyond the town and its immediate vicinity. Proximity to larger urban centres served by better marketing and other economic infrastructure is another important factor, limiting the competitiveness of surveyed firms in the wider market place (e.g. Jabalpur near Gotegaon; Kantabanji near Patnagarh; and Gadawara near Chichli).

Small towns as distribution centres

Although small rural towns may play an important role as market outlets for village households, it is important to note that town enterprises rely on outside supply sources to a much greater extent than local input supply sources (Table 14). A third purchases inputs from towns or cities situated within 50 kilometres and over 40 percent from towns or cities located at a greater distance. Many small firms also procure non-local inputs from retailers and wholesalers within their own town or nearby locations. Many of the goods imported are often traded within town and the local area, with very little value added.

Imported goods often pose no threat to existing local production. That is the case, for example, of refrigerators, televisions, radios, vehicles, mobile phones, medicines, stationery and books. Sometimes, imported goods are even critical to certain economic activities, not only within town but also in surrounding villages. For instance, artisans such as weavers, jewellers, leather shoe makers, brass utensil makers and stone carvers rely on raw materials brought from other regions of India; local farmers require seed and agro-chemicals that are produced elsewhere; and mechanics source spare parts that are not available locally.

Still, certain imported goods can undermine the competitiveness of village level production. In the areas studied, for example, vegetables, rice, flour, wood, garments, shoes, steel utensils and furniture can be cheaper and/or of better quality than local products. In other cases, the competition posed by imports may pre-empt investment in particular activities, such as the manufacturing of agricultural tools and machinery.

Supply sources vary with the type of location and inputs. Not too distant, medium-size locations tend to play a greater role for smaller towns, which normally import modest volumes of relatively un-sophisticated goods. Larger and more distant locations gain prominence as the size of the town increases and consumption patterns become more sophisticated. Hence, while Daspalla is essentially supplied by other small and medium-size towns within a 150 km range, Betul has diversified links with industrial cities within and outside Madhya Pradesh.

Towns as input supply centres

Several examples which illustrate the important input supply function of towns emerged from the fieldwork. Most surveyed locations have dealers that procure equipment, seed and agro-chemicals non-locally for sale to farmers in surrounding villages. They also host a number of units repairing agricultural machinery. In some towns, traders and co-operative societies supply raw materials imported from other districts and states to traditional manufacturing units located at village level, which then supply them with the finished or semi-finished product. Production under contract is widespread amongst weavers around Patnagarh and brass makers in villages surrounding Chichli.

In contrast, only one small manufacturer of agricultural equipment and one producer of agricultural implements were identified in the six towns. The development of these activities is constrained by a relatively weak local demand and competition from firms located in larger rural towns and cities, where enterprises are more able to supply wider markets and enjoy economies of scale.

SECTION IV

CONSTRAINTS TO SMALL TOWN ENTERPRISE DEVELOPMENT

Factors enabling and constraining enterprise development

A strong and dynamic small town enterprise sector, well linked to the surrounding village economy and wider markets, is essential to the development of the rural economy. Strategies and interventions aimed at developing the local economy must therefore address the constraints which inhibit enterprise development in small town centres. In order to gain a better understanding of these issues, survey respondents were asked to identify five key factors that enabled their enterprise to develop (Table 16) and five major constraints that impaired business performance (Table 17).

The fact that a considerable number of responses were incomplete is noteworthy. This not only reveals a certain inability by enterprise owners and managers to understand how the wider context impacts upon their business, but can also be seen as a reflection of the structure of the enterprise sector in the study locations. In other words, very small firms employing few or no workers, using simple technologies, and catering for highly localised markets generally have limited growth potential irrespective of the policy, regulatory, institutional and infrastructural environment. The scope for expansion is limited even in a context where local incomes and demand are rising, since the activities developed are usually characterised by low entry barriers. As profits increase so does the number of competing firms.

It is also important to stress that caution is needed when interpreting the views expressed in the survey. First of all, because the analysis is centred on the constraints experienced by existing enterprises as a whole, it does not provide sufficient insight into the specific problems associated with certain activities and enterprises. Secondly, the opinions of entrepreneurs in dominant activities have a disproportionate influence upon the type of responses obtained, which is unavoidable since the sample is heavily weighted towards the service and traditional manufacturing sectors.

Proximity to markets was regarded as the most important factor enabling enterprise development, eliciting 56 percent of responses, and less than 10 percent of interviewees mentioned *long distance to markets* as a constraint. This is unsurprising given that most firms cater for localised markets. More surprising is the fact that nearly 40 percent of units in the manufacturing sector and 62 percent of units in the service sector reported *high and growing demand*, although one third of manufacturing units did perceive *low and stagnating demand* as an important constraint. As mentioned, most firms sell locally where demand is constrained by the small size of surveyed towns (Betul is an exception) and the high poverty levels in surrounding areas. Furthermore, there is strong evidence of overcrowding in many town-based economic activities: *intense competition* was the most cited constraint to business development, with 60 percent of responses.

Enterprises are exposed to strong competition both in local and more distant markets. Locally, producers of non-tradable goods and services (for example, barbers and local transport service providers) compete with other local suppliers, whereas producers of tradable goods and services (for example, weavers and carpenters) face competition from both local and outside sources. Businesses which rely on distant markets (for

example, agro-processing firms and many traditional manufacturing units) have to compete with non-local suppliers of similar products or close substitutes.

Table 16 – Factors enabling enterprise investment and activity (% of responses)

	Agricultural and food processing	Mining, manufacturing and construction	Services	Total
	%	%	%	%
Proximity to markets	29	46	60	56
High or growing demand	0	39	62	55
Local availability of raw materials	86	51	35	41
Availability of road transport services	29	32	45	41
Availability of skilled labour	29	66	28	36
Good access to finance	14	24	30	28
Low cost of raw materials	57	15	26	25
Low labour costs	14	27	22	23
Access to clean and reliable water supply	14	0	30	23
Road network	14	14	18	17
Low cost of electricity	0	22	17	17
Low competition	0	12	18	16
Low cost of transport	0	10	10	9
Connection to railway	0	5	2	2
Reliable power supply	0	2	1	1
Low cost of water	0	0	1	1
Other	0	22	17	17

Source: Questionnaire survey, July 2002

Local *availability of raw materials* was considered to be an enabling factor by 41 percent of respondents, approximately twice as high as the percentage of respondents who mentioned *limited availability of raw materials* as a bottleneck. Agro-processing firms, agricultural wholesale and retail traders, restaurants, saw mills and carpentries, mining concerns and construction enterprises, among others, rely heavily on local resources. Manufacturing firms also benefit from relatively good access to raw materials, even if these are most often procured from outside the local area.

One in four respondents highlighted the *low cost of raw materials* as an enabling factor, while 15 percent perceived the *high cost of raw materials* as a constraint. Factors that increase the cost of raw materials include limited local supplies, a poorly developed road infrastructure linking towns to villages, and reliance on raw materials imported from distant locations.

Survey responses suggest that the *cost of labour* does not constrain enterprise development within the study towns. These perceptions are likely to be influenced by the low opportunity cost attached to own and family labour, the small number of wage workers employed and low wage rates. Despite low labour costs, study locations are generally failing to attract significant investment into labour-intensive activities,

which tends instead to flow to larger urban centres, partly because enterprises in these locations benefit from better access to support services, technology, inputs and markets.

Table 17 – Factors constraining enterprise investment and activity (% of responses)

	Agricultural and food processing	Mining, manufacturing and construction	Services	Total
	%	%	%	%
Intense competition	14	50	65	60
Poor access to finance	29	48	43	44
Poor road network	0	21	30	27
Unreliable power supply	57	33	19	24
Poor local availability of raw materials	14	24	18	19
Low or stagnating demand	14	33	18	18
High cost of raw materials	0	19	14	15
High cost of transport	0	5	18	14
Poor connection to the railway	0	5	18	14
Poor road transport services	43	7	12	12
Distance to markets	14	12	10	11
High taxes	57	10	9	11
Government bureaucracy	0	12	8	9
Scarcity of skilled labour	14	17	5	8
Corruption	29	5	7	7
Inadequate local repair services	14	12	5	7
High cost of electricity	29	7	4	6
High labour costs	14	5	2	3
Poor access to water supply	14	0	4	4
Other	29	10	27	23

Source: Questionnaire survey, July 2002

Judging by the perceptions of entrepreneurs, one would be inclined to conclude that *skilled labour* is readily available in the study towns. Less than 10 percent of all respondents felt otherwise. More significantly, a considerable proportion of manufacturing firms (66 percent) appears to enjoy easy access to skills. To place these views in proper context, it is important to stress that few enterprises in the study locations require non-traditional skills. In the specific case of manufacturing, the artisanal nature of most existing activity implies that skills are transferred within the household from one generation to the other. The picture would certainly be very different if there was a significant agro-processing and modern manufacturing base.

While 28 percent of respondents viewed *access to finance* as a positive factor in the development of their business, a much higher 44 percent regarded it as a constraint. Personal funds constitute by far the main source of investment and working capital, followed by advances and loans from relatives and friends. One in five entrepreneurs used bank loans to initiate their business activity, but less than one in ten has accessed

formal credit for working capital purposes, an indication that banks (and government schemes) are reluctant to fund current expenditures. In order to circumvent this problem, some entrepreneurs overestimate physical capital needs when applying for bank or government loans and use the surplus as working capital. Entrepreneurs often complained about lengthy and bureaucratic banking procedures and the cost of side payments required to facilitate the loan approval process. Generally speaking, the smaller the enterprise the greater the difficulty in accessing formal credit due to lack of collateral, inadequate accountancy systems, and poor cash flow.

Other constraints to enterprise activity mentioned by a significant proportion of respondents include poor *road connections* and *unreliable power supply*. As discussed earlier, inadequacies in the power supply system, characterised by chronic shortages and voltage fluctuations, are particularly problematic in the case of agro-processing and modern manufacturing firms and remain a significant obstacle to the future development of these sectors.

Surprisingly, few entrepreneurs complained about high taxation, government bureaucracy and corruption. Part of the explanation may lie in the small scale and informal nature of most enterprise activity, where interaction with government agencies is kept to a minimum. The fact that only 18 percent of firms surveyed reported paying taxes is rather revealing. However, India is renowned for having a complex and largely ineffective regulatory policy system which discourages enterprise modernisation and expansion, places an undue burden upon complying firms, and encourages evasion and corruption (Fisher and Mahajan, 1997). Orissa and Madhya Pradesh are no exceptions to the rule.

Business support service needs

Improvements in the external environment under which town enterprises operate (policies, regulations, institutions, infrastructure, agricultural surplus, etc) provide the most effective path towards the development of this sector in a given area. Still, enterprises can also benefit from interventions which address internal constraints. Survey respondents were therefore asked to identify the type of support services (excluding finance) that would have contributed most to the development of their business, as well as their present and future support needs (Table 16).

Once again, many enterprise owners and managers found it difficult to express their needs. Many enterprises have limited requirements due to the small scale of their business and the localised nature of markets serviced. Entry costs are low but so are the opportunities for expansion and the scope for improving business performance through better management practices, the development of new products, the introduction of new technologies and/or improved market linkages. Examples of this type of businesses include small vegetable retailing stalls, tea houses, bicycle repair workshops, rickshaw transport activities, and barber shops.

Given the above, it is noteworthy that over 40 per cent of the businesses interviewed identified the need for skills upgrading in *general and financial management*. Support in *business plan development* is another area where assistance is generally required. While especially important during the early investment stages, it is also relevant for those entrepreneurs planning to expand or diversify their activity and

considering applying for bank loans. These findings confirm the perception that entrepreneurial and management skills in the study towns are somewhat scarce.

Table 18 – Business support needs (% of responses)

	Past %	Present %	Future %
General management	41	45	44
Financial management	34	47	44
Employing skilled staff	30	37	38
Marketing and market linkages	19	30	36
Development of business plan	54	28	28
Developing new products and services	9	26	26
New technology	4	12	14
Vocational training for staff	12	13	12
Computing	0	6	5

Source: Questionnaire survey, July 2002

Over one third of respondents felt the need for support in recruiting *skilled staff*, which suggests that at least for some activities there is restricted supply of relevant skills. It may seem surprising, therefore, that a much smaller number regarded *vocational training* for employees as relevant. There are several possible explanations for these apparently contradictory views. First, workers rarely take on a management role, and it is in this area that the skills gap appears to be wider. Second, workers usually learn to perform technical and menial tasks on the job, sometimes as apprentices. Third, participation in vocational training entails absence from the workplace for a considerable time. Finally, there seems to be a lack of reputed training service providers in most study locations.

Approximately one third of respondents were of the opinion that support in the *marketing* sphere would make a significant contribution to the present and future development of their business, although fewer thought that such services would have made much of a difference in the past. A similar pattern emerges regarding the *development of new products and services*, although not many expressed an interest in services aimed to assist the adoption of *new technologies*, in line with the simple nature of most enterprise activity. Firms already catering for distant markets, with potential to sell non-locally, and/or exposed to outside competition are especially interested in accessing marketing and product development services.

Interestingly, enterprise owners and managers had mixed perceptions regarding the preferred type of service provider. Government agencies and institutions were widely favoured in relation to marketing and market linkage services, whereas the private sector was generally seen as best placed to provide support in technology and business plan development. Opinions concerning the delivery of training and product development services were more or less equally divided between public and private providers. NGOs were disregarded as relevant service providers, which reflects their negligible presence in rural towns and the perception that they work essentially with village households and in areas other than enterprise development. In an environment where government agencies and institutions have an almost complete monopoly over the delivery of enterprise development services within small rural towns, it is very

revealing that such a high proportion of respondents seemed to favour a shift towards private provision. These views highlight the need for more pluralistic enterprise service delivery models.

SECTION V

CONCLUSIONS AND POLICY RECOMMENDATIONS

The role of small towns in local economic development

This study provides insight into the nature of economic linkages between small rural towns and their rural hinterland in four districts of Madhya Pradesh and Orissa. These locations invariably act as local administrative and service centres, and as critical local distribution points for production and consumption goods imported from outside areas. They were also found to play a role as market outlets for village production, but their importance as such varies considerably across locations, depending on the extent to which local production is being channelled to outside markets.

The impact of “exports” on local economic development is particularly significant when benefits are distributed across significant segments of the rural population. This not only ensures strong local growth multiplier effects, but also increases the prospects that the poor will be active participants in the process of economic growth. This issue was insufficiently explored in the study, but there are several indications that at least in some cases the contribution of “exports” to the development of the local economy may be somewhat limited. For example, although considerable numbers of weavers are involved in handloom production, and despite the critical importance of the associated income for the survival of the households involved, this tends to be a part-time activity characterised by low and declining returns. Leaf-plate making constitutes another example of an exporting activity which generates critical but very low and seasonal income to poor households in some forest pockets. In contrast, non-local sales of agricultural produce often involve large numbers of households, inject significant income into the local economy, and generate considerable demand for agricultural labour, production inputs and consumer goods. Agricultural development therefore remains central to any strategy aimed to develop rural areas and improve the livelihoods of rural households.

The importance of small rural towns in mediating between village producers and markets outside the local area is particularly noteworthy when exported goods undergo further processing at town level, and when village producers are linked to town enterprises for accessing raw materials, credit and other support services. The study provides examples of such linkages, but there is potential for strengthening these processes, even in areas characterised by a relatively poor agricultural base. Limited local availability of entrepreneurial and business skills, alongside an adverse investment climate, were identified as significant constraints to an increased market intermediary role by rural town enterprises.

The study further shows that small town enterprises are failing to create significant wage employment opportunities for the population living in surrounding areas. Town firms rarely employ workers from nearby villages due to their limited labour absorption capacity and poor local transport links. Small towns can offer an avenue for local economic diversification into non-farm activities, but mainly through enterprise development and self-employment, essentially but not exclusively in “low-return” activities. Still, the latter often generate greater returns than farming, and provide a more stable source of income throughout the year.

The ability of towns to attract investment and certain types of economic activity is partly a function of their size. Enterprises in larger towns tend to enjoy better access to skills, technology, transport infrastructure and services, public utilities, repair services, and other support services. The smaller towns in our sample do not differ much from very large villages, and this partly explains why they have failed to attract investment into activities such as the manufacturing of simple agricultural tools and processing of locally available agricultural and non-timber forest produce. Such investments tend to flow to larger towns, where enterprises enjoy greater economies of scale and are therefore better able to compete in the wider economy.

Interestingly, data on enterprise ownership signal acute gender and caste inequalities, an indication that enterprise development in small rural towns may not offer a natural route for improved access to self-employment and income generation opportunities for women and disadvantaged castes. This issue merits further research, but the emerging picture suggests that small rural towns reproduce economic and social dynamics at the village level.

Small towns as entry points for policy and investment interventions

The potential contribution of small and dispersed urban centres to local economic development has not been sufficiently recognised in rural development strategies and programmes in India, which have traditionally emphasised the protection of self-employment and at village level (alongside safety nets targeting the most vulnerable households) as the main route to poverty reduction. The instruments and mechanisms through which this objective was pursued include reservation policies, a variety of subsidised schemes implemented in the context of integrated rural development programmes, and a plethora of agencies concerned with village industries, handlooms, scheduled castes and women. Such efforts have largely failed to achieve the intended outcomes, partly because of poor design and implementation, and partly because the activities promoted often had limited growth potential (Fisher and Mahajan, 1997).

There is scope for a more balanced approach, which duly recognises the existing and potential economic role of rural towns and attaches greater importance to these locations as entry points for policy, investment and enterprise development interventions. Several intervention needs were identified in the course of the study. Regarding the business operating environment, four areas deserve special mention: the development of secondary and tertiary road infrastructure; investment in power generation and distribution systems; improvements in the business regulatory environment; and continued reform of the rural financial sector.

It should be noted that weaknesses and problems in these spheres have been highlighted in other studies of the Indian rural economy (see for example NRI Saxena, 2003; Kleih *et al*, 2003; Fisher and Mahajan, 1997) and are well recognised in policy debates across the country. Yet progress over the past decade has been slow. The reasons for this are manifold, and while their analysis goes well beyond the objectives of this study, some examples are presented to illustrate the complexity of the issues at hand and the need for a long-term perspective:

- Most states in India face acute budgetary problems, largely as a consequence of an oversized bureaucracy and subsidised provision of “non-merit” goods, and

therefore find it difficult to mobilise the financial resources required to develop essential economic infrastructure (Srinivasan, 2000).

- Decades of heavy subsidisation have created strong vested interests against reform, as in the case of the power sector, where a reform of electricity tariff policies is urgently required (Saxena, 2003; World Bank, 2001).
- The transition to effective local administrations is made particularly difficult where there is little tradition in facilitating enterprise development, a strong culture of intervention and control, plenty of opportunities for corruption arising from subsidised provision of goods and services, and excessive concentration of discretionary powers in the hands of poorly monitored officials and bureaucrats (Saxena, 2003; Fisher and Mahajan, 1997).
- Finally, creating a rural financial sector which is responsive to local enterprise needs is extremely difficult in an environment of government-sponsored, target-driven allocation of subsidised credit and widespread default, where banks have little incentive to carefully select and develop long-term relations with borrowers (Fisher and Mahajan, 1997).

Another important intervention area identified during the study is the need to enhance and improve local (district and block-level) delivery of business development services. The importance of services focused on entrepreneurial and managerial skill development, product development, market information and marketing linkages was highlighted. There is a wide range of experiences in the provision of such services in the developed and developing world from which India can learn (Levitsky, 2000; Marr, 2003). Particularly relevant lessons include the need for pluralistic models of service delivery and demand-driven (client-oriented) approaches.

The need for new enterprise development approaches

Evidence from this study suggests that the traditional emphasis by government agencies and rural development organisations on village-level artisanal activities with limited growth potential may not be the most cost-effective approach to employment creation and income generation in rural areas. The alternative of channelling support to micro enterprises in rural towns may suffer from similar shortcomings, as these units tend to cater for saturated local markets, thereby failing to drive or even facilitate local economic growth.

A more useful approach would be to place greater emphasis upon activities that sell to outside markets and enjoy favourable growth prospects, add value to locally available raw materials, generate significant employment, and/or provide critical production goods and services to other local activities. These features matter more than enterprise size or location. Examples of economic activities which deserve special consideration include processing of agricultural produce and non-timber forest produce, agricultural storage and trade, transport, manufacturing of agricultural equipment and tools, supply of agricultural inputs, some traditional manufacturing activities, construction, and tourism.

An approach that targets strategic sub-sectors, rather than specific enterprises or activities, is likely to yield high returns (Haggblade et al, 2002). This approach

accounts for market trends, vertical market linkages along supply chains, constraints and opportunities, the policy environment, and the entire range of supportive institutions. It can therefore lead to the identification of systemic policy and investment interventions that can potentially benefit large numbers of players facing similar constraints and opportunities. Interventions will differ across regions, depending on local comparative advantage, patterns of economic specialisation, and existing opportunities and constraints. In some cases, the distinction between rural and urban areas will lose operational validity, since many sub-sectors comprise both rural and urban elements.

The need for institutional change

Institutional innovation is required for effective cross-cutting and sub-sector interventions. Progress in many areas will require systemic change at the national and state levels. Donors should therefore continue to work with the central and state governments to promote policy reforms, improvements in public administration, the development of an enabling business regulatory environment, better prioritisation of public expenditure, reform of rural financial systems, reorganisation of rural development agencies and schemes, and so on. It is crucially important that the private sector and other civil society organisations with a presence in rural areas are properly consulted throughout these processes, and that their views are taken into account. This represents a significant departure from current practice.

There is also considerable scope for positive institutional change at the district level. This will necessarily entail the development of mechanisms for genuine and effective inter-institutional dialogue, co-ordination and collaboration, not only between the public and other sectors, but also across a wide range of government agencies, line departments and local governance (*Panchayat Raj*) institutions (CYSD, 2002; Dasgupta *et al*, 2002). Although the district represents an appropriate geographical unit for local economic planning, such an approach should be extended to broader areas when the issues at hand require co-ordinated solutions beyond the district boundaries.

Whilst multi-stakeholder coalitions at district level are unlikely to bring about radical change in the overall policy environment and the availability of public resources for investment and services, there may be cases where they can influence policy and budgetary decisions at the state and central levels. There is also scope for increased revenue generation at the local level in the context of the fiscal powers devolved to *Panchayat Raj* institutions (CYSD, 2002; Dasgupta *et al*, 2002). While this will require continued efforts over a long period of time, significant benefits can arise from such a strategy, namely through increased investment in (and maintenance of) local economic and social infrastructure, including for example roads and irrigation.

More significantly, multi-stakeholder coalitions are essential for improving the allocation of public expenditure and the running of local government services. For example, the prioritisation of investment in local road and market infrastructure can be improved through participatory planning processes, in which consultation of the private sector leads to better understanding of critical transport bottlenecks. Greater sensitivity to private sector constraints and needs can also result in genuine efforts to enhance enforcement of regulations and reduce harassment by government inspectors and the police. Finally, dialogue and co-ordination amongst rural development

agencies and donor-funded projects can translate into better identification, design and performance of interventions, especially if accompanied by client consultation and pluralistic models of service delivery.

The District Collector, the District Planning Committee (DPC) and the District Rural Development Authority (DRDA) are the leading actors in the process of economic planning at the district level (CYSD, 2002; Dasgupta *et al*, 2002). As such, they must play an active role in bringing about the type of institutional change proposed above. The input from different government departments and agencies, *Panchayat Raj* institutions, business associations, co-operatives, farmer organisations, the banking sector, NGOs and donor-funded projects will be critical for enhancing the impact of public expenditure at the district level, through better allocation of resources and more efficient and effective implementation of activities.

Policy fora structured around key sub-sectors or themes may offer an appropriate mechanism for mobilising relevant stakeholders, improving co-ordination and co-operation, sharing information, identifying constraints and opportunities, and lobbying for change. This and other forms of inter-institutional engagement need to be accompanied by initiatives aimed at addressing the institutional and capacity gaps in the public and private sector. This is likely to include training of officials in key government agencies and department, empowerment of local elected leaders and local governance institutions, and support business associations, co-operatives and NGOs. Donor agencies are well positioned to mobilise a wide range of local stakeholders and promote much-needed cultural change within the public sector. They have an important role to play as catalyst of change.

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