

Rural Economy: Driver of Growth and Poverty Alleviation

Review of Cross-country Experiences

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Key Definitions

Rural Economy: Rural area includes population concentrations in farms, villages and towns below a threshold that varies in official definitions across countries, but frequently refers to concentrations of 5000 or less. Rural regions generally include small towns closely linked to surrounding agricultural areas.

Agriculture: Agriculture consists of crops, livestock, agro-forestry and agriculture would exclude forestry and catch fisheries because their scope and management seem to be different.

Non-farm activities: This includes all rural economic activity outside farm agriculture. It includes self-employment, wage employment, full-time, formal, informal and seasonal, non-farm production.

Driver of growth: An (economic) “driver/motor” is an economic activity that creates growing demand for other economic activities, by two routes: (1) it raises incomes which then are the source of growing consumer demand for the products of the other activities; (2) it creates derived demand on the input (upstream) side for inputs to it from other activities, and creates derived demand for processing and commerce downstream from it.

On-farm and off-farm: Some times rural economic activities are referred as on-farm and off-farm. On farm is activities that are physically on the farm. Consequently, off-farm income includes wage employment in agriculture earned on other peoples' farms together with non-farm earnings.

Composition of Rural Economy

A. Agriculture or Farming

In 2004, 52 percent of the economically active population in developing countries was employed in agriculture.

B. Non-agriculture or non-farm

Composition of RNF employment by Region

Region	% Rural workers employed in RNF	% of total in manufacturing	% of total in trade and transport	% of total in other services	% of total in other activities
Africa	11	23	22	25	30
Asia	24	27	26	31	14
Latin America	35	19	19	27	33
West & North Africa	22	22	21	32	23

Source: Haggblade, Hazell and Reardon (2002)

Typology of Rural Households in Two Groups of Developing Countries

		Farm-oriented					
	Country	Market-oriented	subsistence	Largely Non-form	Transfer oriented	Diversified	Total
Agricultural Countries	Nigeria	11	60	14	1	14	100
	Ghana	13	41	24	3	19	100
	Malawi	20	14	24	3	39	100
	Nepal	17	8	29	4	42	100
	Nicaragua	18	4	45	0	33	100
Transforming countries	Vietnam	38	4	18	1	39	100
	Pakistan	29	2	34	8	28	100
	Albania	9	10	15	10	56	100
	Indonesia	16	0	37	12	36	100
	Guatemala	4	7	47	3	39	100
	Bangladesh	4	2	40	6	48	100
Farm oriented household (more than 75% of total income from farm production)							

Roles, Inter-linkages and Significance of Farm and Nonfarm Sectors in the Rural Economy

- The RNF is an important part of the rural economy in almost every case, providing between 40 and 60% of income and jobs in rural areas;
- Much of RNF activity arises in trading and in the processing of agricultural and other primary products.
- Much of the RNF provides good and services for the local, rural economy. Little of it is tradable and its growth depends on that of other rural activities, above all, agriculture;
- The RNF is mostly small-scale, using little capital, and which is low productivity and offers low returns, and activities that operate at larger scale, with more capital investment, are generally less prevalent
- Low-capital, low return activities are accessible to the rural poor, the activity is essential in mitigating poverty and preventing destitution, but it is less clear that it can eradicate poverty. Some rural non-farm activities provide support to growth sectors

How Agriculture Drives Growth and Poverty Alleviation

How agriculture can contribute to development differs across three broad categories of countries: agriculture dominated, transforming, and industrialized. In the first, which comprises most of the Sub-Saharan African countries, agriculture accounts for a large share of GDP growth and most of the poor are in the rural sector. To grow and reduce mass poverty, these countries have little option than a well performing agriculture.

In transforming countries, which include most of Asia, the Middle East and North Africa, and part of Europe and Central Asia, economic growth is rapid in other sectors but a large share of the poor remain in rural areas. Growth in agriculture and in the associated rural non-farm economy is needed to reduce poverty and confine rising rural-urban income disparities.

In urbanized countries, which include most of Latin America and part of Europe and Central Asia, poverty is predominantly urban and agriculture is an economic sector that can be quite dynamic but contributes a small share of GDP growth.

Why Rural Economy (Primarily Agriculture) Can be the Driver for Growth and Poverty Alleviation

- I. Agriculture has multiple functions for development, with three fundamental functions: an economic activity, a way of life, and a provider of environmental services.
As an economic activity, it can be a source of growth for the national economy, a provider of investment opportunities for the private sector, and a prime driver of agriculture-related industries and the rural non-farm economy.

As a way of life, it is source of livelihoods for the majority of rural populations, of food security for people facing food market failures, of jobs for landless workers and marginalized smallholders, a harbor for surplus populations.

As a user and frequently as a mis-user of natural resources, it can create good and bad environmental spillovers for the poor.
- II. The scope of agriculture for development is substantial.

Special Powers of Agriculture in Reducing Poverty

Agricultural growth has special power in reducing poverty.

Using a cross-country estimate for 42 countries over 20 years it has been shown that for the two-third poorest in the distribution of income, GDP growth originating in agriculture has more impact on income than growth originating in non-agriculture, which benefits the richest third more.

For China, aggregate growth originating in agriculture was estimated to have been 3.5 times more effective in reducing poverty than growth originating in non-agriculture. For Latin America, their ratio was found to be 2.7.

Source: World Bank

Emergence of Rural Non-farm Economy

The present structure of the rural non-farm economy in developing countries results from an ongoing economic transformation.

As population density and market access increase, new technologies and modern farm inputs become available, leading to increased agricultural surpluses in some commodities and increased opportunities for trade.

As agriculture grows, it stimulates growth of the RNFE through a number of key linkages:

- Rising labor productivity on the farm increases food supplies and releases farm family workers to undertake non-farm activities;
- Increases in farm incomes, together with high rural savings rates, make capital available for investment in non-farm activities;
- As agriculture modernizes and its productivity grows, it requires additional inputs and services marketing and processing of output with a growing demand for non-farm firms providing these inputs and services; and
- As their incomes increase, farm households, like good consumers everywhere, spend much of their new income on a range of consumer goods and non-farm services.

As rural towns grow they stimulate growth in rural non-farm activity.

As the rural economy continues to grow, trade with larger urban centers also expands, and more urban goods become available.

Emergence of RNFE: 3 Examples

India. The importance of wage employment and of services normally increases in the rural non-farm economy, both over time and as urbanization penetrates rural zones. In rural India, the share of both wage employment and services has grown over time. (Bhalla 1981, 1977).

Nicaragua. Similarly in Nicaragua, higher share of wage employment and services emerged in the more densely populated areas in, those better serviced by roads and with a greater share of population living in rural towns. Rural non-farm wage employment and services became very important. (Corral and Reardon 2001).

Chile. In dynamic agricultural zones, such as the horticultural export boom region of central Chile, the rural non-farm service sector grew rapidly during the 1990s, fueled by rapidly rising farm incomes and consumer diversification. In these zones, commuting daily between rural areas and rural towns increased substantially.

Source: IFPRI

Role of RNFE in Poverty Alleviation

Rural landless and near-landless households depend heavily on non-farm income source. Those with less than 0.5 hectare earn between 30 and 90 percent of their income from non-farm activities (Hazell and Haggblade 1993). The poor face great pressure to explore opportunities in the rural non-farm economy.

Non farm income also provides an important tool for the poor in stabilizing household income during drought years (Gordon and Craig 2001).

Because non-farm income proves important for financing on-farm investments, non-farm earnings become important to food security both directly by helping the poor to buy food and indirectly by financing the purchase of farm inputs necessary to increase food production.

Gender, caste and social status can restrict access by the poor to the most lucrative non-farm activities in some setting. In the same way, child-rearing obligations may limit women's mobility and force them into home-based, highly labor-intensive pursuits such as weaving, silk rearing etc.

Can RNFE be a Driver of Growth

Most commonly, agriculture produces the main tradable in rural regions, but so can natural resources extraction activities like mining and logging, and tourism (a way of exporting services).

Many, though not all, RNFE activities are regional nontradables and are handmaidens rather than engines of growth. In some instances, however, especially in the more liberalized economies of today, export potential of rural non-farm goods and services can serve as motors of rural economic growth.

Independent motors of growth in the rural economy include tourism, mining and quarrying, and rural sub-contracting of some manufacturing processes by urban-based firms.

The amount and type of such tradable opportunities vary enormously across regions, depending on such key factors as agro climatic conditions, access to roads and markets, and the health and structure of the surrounding national economy, its per capita income, growth rate, and accessibility.

Why Agriculture is the Key Driving Force for Growth

There are several ways agriculture would be driving growth:

One is simply arithmetic. It is often a large sector of the economy and so its growth contributes to overall growth. Non-tradability of food still applies across much of Sub-Saharan Africa and other agriculture-based countries for two reasons: high transactions cost due to poor infrastructure compounded further in the many landlocked countries; and staple foods such as roots and tubers and secondary grains that are not internationally traded.

Agricultural productivity growth in such a closed system leads to declining food prices and lower wages to other sectors which consequently grow faster.

The result: agriculture's shares of GDP and the labor force both decline in the well known structural transformation of an economy led by a well performing agricultural sector.

Poverty declines also due to productivity gains for smallholders and rising real wages for workers in all sectors induced by lower food prices.

Agriculture is likely to become a major source of growth when the economy opens and transactions costs are reduced.

Prospect of Growth in Agriculture (continued)

Total factor productivity (TFP) in agriculture has grown faster than in industry in many settings (World Bank Report).

In 14 industrial countries TFP grew at 2.6 percent per year in agriculture, compared with 1.2 percent in industry and 0.7 per cent in service between the early 1970s and the late 1980 (according to a 1996 study by Bernard and Jones)

For 50 low and middle income countries during 1967-1992 the average growth in TFP was 0.5 to 1.5 percentage points higher in agriculture than in nonagricultural sectors (according to a World Bank report).

Brazil and Chile – where agricultural commodities have become mostly tradable and where growth in agriculture has exceeded growth in nonagricultural sectors for more than a decade – confirm that agriculture can be a dynamic sector.

Prospects are much Greater Now

The new context for agriculture is defined by globalization and the emergence of new markets, far reaching technological and institutional innovations, and new roles for the state. It is characterized by:

- Global market shifts, with a rise in demand for high value products, integrated food supply chains, giant agribusiness corporations, the supermarket revolution at the retail level, requirements for suppliers to meet strict quality standards, a secular decline in the price of staple foods and tropical exports in international markets
- Technological and institutional innovations that increase productivity, but also introduce new requirements for competitiveness.
- The descaling of the state in directly providing goods and services to agriculture through parastatal agencies, replaced by an increasing role in providing public goods and regulating market activity.

There are also New Challenges in Agriculture

Supply-side factors such as climate change, environmental degradation, higher energy prices, and doubts about future rates of technical change all present challenges and risks.

To meet projected demand, cereal production will have to increase by nearly 50 percent from 2000 to 2030, and meat production by 120 percent.

Added to this is the burgeoning demand for agricultural feed stocks for bio fuels, which could push up world food prices.

So the challenge is how can the increased demand for agricultural products be met in the face of growing natural resource constraints and unanticipated shocks?

How to Make Agriculture More Effective Driver of Growth and Poverty Alleviation

- Make small holders farming more productive and sustainable differentiated policies
- Get price incentives right and increase the quality of public investment
- Make product and factor markets work better
- Improve access to financial services and reduce exposure to uninsured risks
- Promote innovation through science and technology
- Make agriculture more sustainable and a provider of environmental services

Ways to Make RNFE Contribute More to Growth & Poverty Alleviation

- Basic elements of an RNFE policy include the importance of having the physical infrastructure in place and universal education. The lessons of micro-finance are being learned and may provide useful lessons and application for the RNFE.
- Supply chain analysis and of the potential for clustering of rural business merit attention.
- Information on market opportunities should be made more readily available.
- It is well recognized that poorly functioning financial systems in rural areas are an impediment to growth, but the development of more credit facilities should be complimented with training on how to develop business plans and approach financial institutions.

A DFID study reviewing 55 projects reached the conclusion that

The RNFE cannot be said to definitely act as a driver for the rural economy, independent of agriculture or other primary activities. However, certain non-farm activities are not only reactive to rising production and income in primary sectors but can also facilitate or even initiate growth in these primary activities. Linkages work both ways, from agriculture to non-agriculture sectors, and vice-versa.