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Policy Initiatives for Strengthening Rural Economic Development in India:

Case Studies from Madhya Pradesh and Orissa

Nandini Dasgupta, Ulrich Kleih,
Alan Marter and Tiago Wandschneider



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DFID Department for
International
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The Natural Resources Institute (NRI) of the University of Greenwich is an internationally recognized centre of expertise in research and consultancy in the environment and natural resources sector. The Institute carries out research and development and training to promote efficient management and use of renewable natural resources in support of sustainable livelihoods.

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Acronyms and Abbreviations

BDO	Block Development Officer
BDS	Business Development Service
CBO	Community-based Organization
CMS	Cirrus Management Services
CSS	Centrally Sponsored Schemes
CYSD	Centre for Youth and Social Development
DFID	Department for International Development, UK
DPC	District Planning Committee
DRDA	District Rural Development Authority
NGO	Non-Governmental Organization
NTFP	Non Timber Forest Product
NRI	Natural Resources Institute, UK
PRA	Participatory Rural Appraisal
PRI	Panchayat Raj Institution
RNFE	Rural Non-Farm Economy
SL	Sustainable Livelihoods
SME	Small and Medium Sized Enterprise
SPSS	Statistical Package for Social Sciences

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Introduction

The purpose of this publication is to present the findings of research concerned with improved understanding and appropriate policy development for the rural non-farm economy (RNFE) in India. The research was undertaken by the Natural Resources Institute (NRI) in collaboration with local partners¹; with funding from the UK's Department for International Development (DFID) under a collaborative agreement with the World Bank. The two Indian states selected for analysis were Madhya Pradesh and Orissa.

Research objectives of this study sought to inform policy on two interrelated topics:

- sources of farm and non-farm income in rural households; barriers to uptake of non-farm employment; and opportunities which can be translated into policy recommendations
- the effect of local governance on the development of the RNFE in particular and rural development in general; and the opportunities for making local governments more responsive to local needs.

The Policy Context

Rural development and access to the rural non-farm economy

As in many other developing countries, the number of poor people in rural areas of India

exceeds the capacity of agriculture to provide livelihood opportunities. Although population growth is slowing, this is not expected to change the situation significantly, and neither out-migration nor urban areas can generate adequate livelihood opportunities for all those unable to make a living from agriculture. For these reasons the RNFE has a potentially significant role in the livelihoods of poor people in rural areas.

Over the past five decades, India has pursued many policies focused on poverty reduction and promotion of economic growth. However, their impact on poverty has been limited, and growth in both the RNFE and agriculture has been constrained. These policies generally focused on supply side components (Saxena, 2003), especially credit programmes, coupled with decentralization. Interventions were intended to improve livelihood opportunities by creating jobs or the conditions in which jobs are created. There has been relatively little focus on the factors that determine poor people's *capacity* to take advantage of these job opportunities. Review of the literature (Ellis, 1999; Barrett and Reardon, 2001) and experience in India (Fisher *et al.*, 1997) show that livelihood diversification can be driven by two processes: *distress-push* – where the poor are driven to seek non-farm employment for want of adequate on-farm opportunities; and *demand-pull* – where rural people are able to respond to new opportunities. In the former situation, large numbers may be drawn into poorly remunerated activities (but ones which have low barriers to entry), whilst the latter are

¹ In Madhya Pradesh, the collaborators were Debate and Samarthan; in Orissa, they were ActionAid-India and the Centre for Youth and Social Development (CYSD). In addition, Cirrus Management Services (CMS) undertook a small-town survey in both states.

more likely to offer a route to improved livelihoods. This research aims to provide more information on access constraints faced by poor people seeking to work in the RNFE.

The literature highlights the role of assets as influencing the ability of households to engage in non-farm activities. These assets include: health and nutrition; household demographic composition; education and skills; access to finance and wealth; infrastructure; and social capital and networks. This study will examine these in relation to income levels at the household level. However, the way these assets interact to generate income is largely conditioned by government policies and institutions and the nature of local governance.

Rural development, the rural non-farm economy and local governance

In 1993, the 73rd amendment to the Indian constitution² made it obligatory on all state governments to establish local governments in rural areas, in the form of a three-tier structure known as the Panchayat Raj Institutions (PRIs). The objectives behind this decentralization were to enhance democratic development and to speed up the sluggish rate of rural development and poverty alleviation. This was also in line with donor-thinking which saw top-down implementation of policy as one of the causes of weak governance. It was envisaged that decentralization would allow local politicians to target local developmental needs and problems.

Blair (2000)³ conceptualizes the argument that establishment of local democratic government will ultimately lead to reduction in poverty as a five-stage process. The expectations are that there will be:

- increase in participation
- increase in representation
- increase in empowerment
- increase in benefits for all
- decrease in poverty.

A review⁴ of the impact of decentralization has shown that with decentralization (administrative, fiscal and/or political), the political participation of people increased but did not lead to their empowerment. The traditional power structures were left intact. This has led to the realization that a strategy to increase democratic development *per se* could merely redistribute powers and functions from the central to the local level. By itself such redistribution does not ensure that the institutions of local government are able to advocate, facilitate or promote growth that is equitable or sustainable. Recent empirical evidence from Africa underscores this thinking. Ellis and Mdoe (2003: 1367), based on research in Tanzania, note that local governments could “make worse the public sector institutional environment within which people attempt to construct their own pathways out of poverty”. Orr *et al.* (2001) and Ellis and Mdoe (2003) argue that in Malawi the present institutional structure does not foster the diversification of rural activities. The situation could be further aggravated by fiscal decentralization as rural assemblies would impose new business licences and commodity taxes.

It is in this overall context that this research sets out to examine the role of the institutions of local governance and their impact on non-farm activities; people’s awareness and perceptions of the powers given to them and to their representatives; and awareness among the constituency and the local leaders of the developmental roles and functions assigned to PRIs. An assessment of all stakeholder

² Government of India (1993) 73rd Amendment to the National Constitution sets out the mandatory provisions which the states were required to implement and identified areas of discretionary powers for the state governments.

³ For a detailed discussion of Blair (2000) and a literature survey of the RNFE and local governance, see NRI Report No. 2672.

⁴ Sri Lanka (Abeyawardana, 1996); Philippines (Carino, 1996); Thailand (Rigg, 1991); Bolivia (Gonzales, 1997; Grootaert and Narayan, 1999); Bangladesh (Westergaard and Alam, 1995); and India (Manor: 1995; Aziz *et al.*, 1996; Crook and Manor, 1998; Manor, 1999).

perceptions was fundamental to understanding the extent to which the PRIs have created an enabling environment for rural development and/or created/maintained the institutional blockages that hinder rural households from moving out of poverty. The overall aim is to identify opportunities for improving the institutional context for livelihood diversification, RNFE growth and poverty reduction.

Definitions

The RNFE includes activities that are outside primary agriculture, forestry, animal husbandry and fisheries, whether carried out on one's own farm or as labour on others' farms. The main criterion for identifying non-farm activity is – does the activity add value to the product, irrespective of the fact that the product has been generated as on-farm activity. For example, if cleaning grain before it is sold fetches a different price from grain that has not been cleaned, the activity 'cleaning grain' will be a non-farm activity.

The Census of India classification of all workers into nine 'industrial' categories, was not appropriate for this study. Hence, the classification of sub-sectors developed by Fisher and Mahajan (1997) to represent the RNFE in India was used and includes: agro-processing, commercialized allied activities, mining, household and non-household manufacturing,

repairs, construction, trade, transport and other services (Fisher and Mahajan, 1997: 11).

The term 'local governance' in the study refers to both formal and informal institutions of governance. The former includes the PRIs, and the latter includes the civil society organizations, the private sector and lending/donor agencies. This study adopts the definition of civil society developed by Tandon and Mohanty (2000) and used by the DFID office in Madhya Pradesh. (DFID-MP, 2000). Civil society is defined as "the space independent of the state and the market". It is conceptualized as the sum total of all individual and collective action intended for public good.

Choice of Study Area

The decision to focus on Madhya Pradesh and Orissa was taken at the national level following discussions between DFID-India, the World Bank and central government officials. Poverty reduction is at the core of this project and the states selected are among the poorest in India as illustrated in Table 1.

In each state, two districts were selected for in-depth study. The selection of districts was purposive in nature following wide ranging consultations with government officials in Delhi, Madhya Pradesh and Orissa⁵. The districts selected in Madhya Pradesh are Narsimhapur and Betul; Nayagarh and Bolangir in Orissa.

Table 1: Concentration of poverty in selected states

State	Percentage share of India's population (2001)	Percentage of population living in poverty (1999–2000)
Madhya Pradesh	7.91	37.43
Orissa	3.57	47.15
Bihar	10.69	42.60
All India	100.00	26.10

Source: Government of India, Poverty Estimates for 1999–2000; Census 2001 Provisional Population Tables

⁵ For a more detailed discussion, see Dasgupta *et al.* (2002) .

Furthermore, Betul and Bolangir are in areas regarded as spatial poverty traps on the basis of agro-ecological and socio-economic conditions (Singh and Binswanger, 1993), that is, forest-based economies, especially in the hilly regions with a predominance of tribal populations and with limited access to natural resources, information and markets.

Within each district, the criteria used to select blocks and Panchayats were: (i) level of RNFE activity; and (ii) level of access to roads. See the Appendix for details of blocks and PRIs selected.

Research Approach and Methodology

The aim of the research was to inform state and national policies and macro-level donor policy. This required a holistic approach and an analytical framework that allowed links to be made between different policy levels. The sustainable livelihoods (SL) framework provided the structure for such an analysis and informed the methodology developed for this study.

Research approach

The SL approach provides a framework for analysing the diversification of rural livelihoods for policy development. It shows that a livelihood comprises assets, activities and access to these (mediated by institutions and social relations), which together determine the living gained by the individual and the household. A livelihood is sustainable when it can cope with, and recover from, stresses and shocks and maintain or enhance its capabilities and assets, both now and in the future, while not undermining its natural resource base. The SL framework is a valuable tool to judge the performance of non-farm rural livelihood policies. It is thus, a useful means to inform policy interventions.

The social unit of analysis is the household, with the starting point being the assets base upon which households draw. Assets are described as

stocks of capital (natural, physical, human, financial and social) that can be utilized directly or indirectly to generate the means of survival or sustain its well-being at different levels of survival. Access to these assets is mediated by a number of contextual social, economic and policy considerations. Ellis (2000) made the distinction between endogenous and exogenous factors. He argued that social relations, institutions and organizations are factors that are predominantly endogenous to the social norms and structures of which households are a part. The exogenous factors are trends and unforeseen shocks (e.g. floods) and impacts of policy (e.g. opening up the market for agricultural inputs to the private sector) with major consequences for livelihood viability. The interrelationships between assets, mediating processes and livelihood activities are dialectic, complex and dynamic.

The SL framework was adopted for this study because it allows a holistic approach to the analysis of a household's capacities and constraints in the access of resources to generate livelihoods and, at the same time, allows this analysis to be linked to the wider contextual endogenous and exogenous factors operating at different levels (state, national and global). This approach combines participatory approaches to understand institutional structures, socio-economic processes and peoples' perceptions, with objective quantifiable measures of income, economic links and livelihoods.

Research design and methodology

The wider approach taken by the study team was to move from an overall understanding of households, communities and institutional structures to an in-depth understanding at household level. To this end research was carried out in two phases. Fieldwork for Phase I was undertaken between November 2001 and February 2002. For the access component, a participatory rural appraisal (PRA) was carried out to provide insight into common problems,

constraints and opportunities in the study area. Qualitative and participatory techniques, described in Table 2, were used. Key issues assessed included predominant types of household assets, income generating activities, social and gender-related issues, and constraints and opportunities encountered by the poorer households in taking up new income generating activities.

Concurrently, for the local governance component, an analysis of the formal and informal institutions of local governance was undertaken to assess the devolution of powers and functions, the relations between government functionaries and the elected representatives and their respective abilities to deliver public services.

In Phase II, based on the findings of Phase I, a questionnaire-based household survey was designed to include issues arising in both access and governance components. The survey covered 800 households in each state. The *chulla*⁶ was taken as the means of defining the unit of the household and not the physical structure of house. In the period, April–October 2002, the questionnaire survey was carried out by local

collaborators in the same villages where the PRA and local governance survey had been undertaken. The survey design was based on a proportionate random sampling framework to reflect the population size of the different villages. The data were analysed using SPSS statistics software.

For the access component, the main objective of the questionnaire survey was to obtain statistically valid data which could be used to back up the findings of the PRA. This included information on household demography, socio-economic context, asset base, income sources and levels, and perceptions of constraints on access to employment opportunities outside agriculture.

For the local governance component, the household survey examined the impact of decentralized government on local activities; the relationship between donor-funded projects and local democratic institutions; the links between line departments and PRIs; people's awareness of the powers and functions of the formal institutions; and people's perception of who are the more effective agents of economic development.

Table 2: Tools and techniques used for the PRA

Issue(s) purposes	Tools used
Assessment of community (physical/natural) assets	Social mapping
Exploration of local resources and development conditions and observation of physical, natural and capital assets	Transect walk
Understanding of specific income generating activities undertaken by individuals and small organizations (key issues)	Focus group discussions
Gaining in-depth knowledge of specific issues, structure and organizations	Key-informant discussion/in-depth interview
Following up and illustrating specific issues	Case studies/semi-structured interviews
Stakeholders perceptions	Semi-structured interviews
Income generation present, future and trend and constraints	Ranking/focus group discussion/service opportunity map/seasonality calendars

⁶ A household is defined as all individuals whose food is produced from a single *chulla* – a stove made locally of mud used for cooking. The fuel used is generally wood or coal.

Small towns surveys

Additionally, following the analysis of Phase I results, it was concluded that it was important to understand the nature of the economic links between rural settlements and the small and district towns. A rural-urban linkage study was, therefore, also undertaken during Phase II. The survey was structured around the enterprise sector, since an understanding of enterprise activity provides insights into the extent of spatial economic linkages. Information was collected on the type of economic activity developed, the interaction between enterprises and input suppliers and customers, and enterprise employment patterns. The views of entrepreneurs on factors which have enabled and constrained business development, and their perceptions concerning enterprise support needs, were also elicited. These provided insight into policy and investment interventions which are likely to stimulate the growth of the rural town enterprise sector and thereby enhance local economic development.

Fieldwork was conducted in six towns. A total of 183 structured interviews were carried out with

enterprise owners and managers and 30 semi-structured interviews with key informants in the enterprise and government sectors. Enterprises were randomly selected, although there was an explicit attempt to include firms operating in different sub-sectors and to provide as balanced a representation as possible of the variety of economic activities found in the six study locations. (Table 3).

Cirrus Management Services (CMS) implemented the survey in collaboration with local NGOs⁷ and contributed to data processing and analysis.

Plan of Report

The study design and analysis in this report are at three levels. These include analysis of access and constraints to the RNFE at the household level; the meso-level analysis of the role of small towns and rural-urban links in the RNFE; and the village, district and state level analyses of local governance issues. The report is structured to reflect this multilevel analysis.

Table 3: Population and location of study towns

Town	District	Town population 2001	Distance to district headquarters (km)	Distance to state capital (km)
Betul	Betul	83,485	0	180
Gotegaon	Narsimhapur	23,417	31	231
Chichli	Narsimhapur	9250	68	175
Patnagarh	Bolangir	18,685	38	418
Daspalla	Nayagarh	<10,000	40	290
Odagoan	Nayagarh	<10,000	26	276

Source: Census of India (2001)

⁷ Debate and Samarthan participated in the fieldwork in Madhya Pradesh, while ActionAid and the CYSD assisted the research team in Orissa.

Introduction

Using the SL approach as the entry point (see above), this section analyses the asset base of households, their livelihoods and income patterns, and constraints on entry to non-farm livelihoods. In particular, an attempt has been made to establish links between the capital assets available to households, and how the latter are able to make use of them in the face of external factors such as the economic environment and vulnerability context. However, first a brief description of the socio-demographic background is given. Although the same questionnaires and

approach were used for the surveys in both states, the respective teams chose slightly differing analytical methods for some topics.

Socio-demographic Background Information

Table 4 provides some selected socio-economic background data for the households in the four survey districts, that is, two in Madhya Pradesh (Betul and Narsimhapur) and two in Orissa (Bolangir and Nayagarh). Interestingly, with 4.9 members per household, the average household size is smaller in Orissa than in Madhya Pradesh,

Table 4: Socio-demographic background information on Madhya Pradesh and Orissa

	Madhya Pradesh (Betul and Narsimhapur)	Orissa (Bolangir and Nayagarh)
Sample size		
Households interviewed (number)	799	800
Household composition		
Female-headed households (%)	4.8	5.3
Average size of households (mean)	5.9	4.9
Average age of household heads (mean in years)	44.76	44.79
Total male adults per household (mean)	1.8	1.6
Total female adults per household (mean)	1.6	1.5
Total number of income earners per household (%)	41.0	39.9
Caste composition (% of households)		
General castes	17	6
Other backward castes	27	45
Scheduled castes	14	35
Scheduled tribes	42	14

Source: Questionnaire survey (July 2002)

Note: The *chulla* was taken as the means for defining the household unit for the survey (see above).

where it is 5.9 members. This may be due to socio-economic factors such as smaller landholdings in Orissa or a higher level of outward migration, resulting in smaller households. Approximately 5% of households are headed by females in both states and the average age of the household heads is also almost identical (i.e. 45 years). The figures for both states show that there are more adult male members in households than adult female members, and that about 40% of household members are income earners, indicating a relatively good dependency ratio.

The caste composition shows some marked differences, in that Orissa has substantially more households belonging to other backward castes and scheduled castes, whilst Madhya Pradesh has a higher proportion of general/upper castes and scheduled tribes. However, these figures are masking geographical differences within the two states, for example, Betul District in Madhya Pradesh has a much higher tribal population than Narsimhapur District. A key aspect is that the proportion of households from scheduled castes and scheduled tribes is around half of the total in both states, indicating large numbers of very poor people.

The Household Assets Base

Access to a number of key capital assets has been examined from an RNFE viewpoint. Access to land, other natural resources and livestock has been included given that these assets are often important for the development of non-farm livelihoods in rural areas. Agricultural production is also important for the development of the non-farm sector in that spin-off effects are created as a result of upstream and downstream linkages (Davis, 2003; Haggblade *et al.*, 2002; Reardon *et al.*, 1998).

Access to education

Skills, knowledge and information are generally seen as a prerequisite for households to be able to

take advantage of many new livelihood opportunities. In addition, it is accepted that access to education is generally required for the formation of this type of human capital. As Table 5 highlights, a major proportion of the rural adult population in the survey areas is illiterate, but the situation is significantly worse for women. For example, in Madhya Pradesh, about one third of adult males and two thirds of adult females are illiterate. Of the households who are not literate, few have education levels beyond primary education and very few household members have obtained some form of formal vocational training.

The key issues in education are how to reduce the high level of illiteracy, and how to develop a curriculum that takes labour market requirements into account more effectively. Whilst the majority of children now go to school, some of the marginalized families are not able to send their children regularly. For example, migrant workers may take their children with them when they move to other districts or states. Agricultural wage labourers sometimes consciously take the decision to take children with them to the fields, arguing that this type of informal training is required as part of their education in order to be able to earn a livelihood later in life. On the other hand, if children of migrant workers are left behind in their home village, then it is often the older girls of the family who are required to look after their siblings, which is likely to compromise their education.

It was also reported that parents are becoming disillusioned about the usefulness of education given that young adults find it difficult to obtain jobs corresponding to their qualifications. In this context, it appears important that in future there is a better balance between academic education and vocational training. Youngsters can be introduced to the latter at the age of about 12 years, where practical topics can be taught with a view to broadening their long-term skill base (e.g. animal husbandry, food processing, health care, information and communication technology, mechanical repairs, etc.). Curriculum formulation for vocational education should also

Table 5: Access to selected livelihoods assets in Madhya Pradesh and Orissa

	Madhya Pradesh	Orissa
Human capital – access to education		
Illiteracy – % of total population	n.a.	40
Illiteracy – % of female adults	64	n.a.
Illiteracy – % of male adults	35	n.a.
Primary education – % of total population	n.a.	37
Primary education – % of female adults	13	n.a.
Primary education – % of male adults	18	n.a.
Social capital		
Membership of self-help groups (% of households with members belonging to self-help groups)	11	29
Natural capital		
Land ownership (% of households owning land)	58	70
Average size of land holdings* (mean, acreage)	8.4	2.2
Access to forest land (% of households with access)	35	71
Access to common grazing land (% of households with access)	19	80
Livestock ownership (% of households owning animals)		
Dairy cows	34	17
Non-dairy cows	24	11
Oxen/bullocks	44	41
Buffaloes	20	6
Calves/heifers	40	14
Goats	10	15
Poultry	16	13
Ownership of physical assets (% of households owning assets)		
Tractor	6	0
Ox-cart	38	12
Plough	42	37
Irrigation equipment	27	4
Thresher	7	0
Flour mill	2	0
Motorcycle	11	5
Bicycle	41	52
Television	25	5
Radio	14	14
Sewing machine	9	1
Loom/spinning equipment	0	0
Access to electricity (% of households having access)		
Electricity at home (e.g. for lighting)	83	13
Electricity at farm (e.g. for equipment such as pumps)	22	1
Electricity for household industry (e.g. for mills)	2	0

Source: Questionnaire survey (July 2002); figures have been rounded

*Only takes into account households that actually own land.

take into consideration the views and demands expressed by local entrepreneurs who are potential employers.

Land ownership

Reflecting the natural resources endowments of the two states, the average size (3.4 ha) of landholdings is considerably larger in Madhya Pradesh. At the same time, it is important to note that only 58% of rural households own land in Madhya Pradesh and that average farm size figures in both states also tend to hide the fact that some farmers may own quite substantial landholdings (e.g. 40–80 ha [100–200 acres] in a few cases), whilst a substantial proportion own less than an acre. The scale of landholdings broadly reflects caste categories, for example, the general castes have the largest holdings of fertile land, followed by the other backward castes. In tribal areas, the scheduled tribes are more likely to have access to land than the scheduled castes, who tend to have the smallest landholdings or are landless.

In Orissa, 70% of rural households own land, but the average size is only 0.9 ha (2.2 acres) (Table 5). The land ownership patterns appear to be a factor contributing to distress-push diversification into other livelihoods options, including migration. On the other hand, rural communities in Madhya Pradesh are more likely to rely on agriculture in the foreseeable future. For example, there are fertile agricultural areas in Narsimhapur that attract migrants from other parts of the state or country.

Accessibility of common grazing land and forests

Access by the community to these resources is an important component of rural livelihoods, firstly through supply of fodder for livestock and second through provision of access to forest produce (both timber, including fuelwood, and non-timber products), for household consumption and marketing. Access to common grazing land is available to the majority of households in the areas surveyed in Orissa, but only to one third of households in Betul District

and less than 10% in the agriculturally dominated Narsimhapur. Access to common grazing is often eroded by encroachment, by either the wealthy or the landless.

Livestock ownership

Ownership of animals is important in the RNFE context, as it often provides a secondary income for households and also represents one of the entry points into non-farm livelihoods. Bullocks and cows are the most commonly owned animals in the villages. Whilst ownership of bullocks and oxen is similar across the two states, there are marked variations in the ownership of cows. In particular, households in the agriculturally richer district of Narsimhapur are more likely to own dairy cows (i.e. about 50%), whilst in the other districts, this percentage is of the order of 12–20%. Nevertheless, there are factors that inhibit the exploitation of the full potential of dairy production, most notably, the lack of an integrated marketing and processing system. In this respect, lessons can be learned from other states such as Gujarat.

Although goats and poultry are usually considered a useful option for poverty reduction amongst marginal groups, ownership of such livestock is low. Constraints to livestock ownership include the unavailability of pasture, particularly for the landless and marginal farmers, inadequate veterinary support, and the amount of care required by poultry. In addition, larger-scale landowners reportedly discourage goat herding in the villages for fear of damage to their crops.

Access to finance

Credit has been frequently stated by survey participants as a prerequisite for entry into non-farm livelihoods. Information was sought on both formal and informal credit institutions, however, it proved difficult to obtain a clear picture since many villagers were reluctant to discuss financial matters. Reasons for this include the fear of association with a defaulter's status in the case of formal banks, and in the case

of informal loan sources, fear that giving information might have negative repercussions on future loan availability from money-lenders. On the other hand, interviewees were more forthcoming when asked for specific constraints associated with each loan source.

Whilst recognizing these caveats, it is apparent that formal credit is, or has been in the past, accessed to a fairly wide extent in both states (e.g. 23% in Bolangir) from sources such as commercial banks, co-operative banks, or rural development schemes (e.g. Integrated Rural Development Programme). At the same time, it is also apparent that many households became debt defaulters as a result of using credit for unviable enterprises. According to the study, formal loans are mostly taken out for agricultural production, and to a lesser degree for non-farm enterprises.

Despite substantial amounts of resources spent by the government on credit programmes and expanding the rural banking network, the overall impact on enterprise creation and poverty reduction has been disappointing. According to Fisher and Mahajan (1997), reasons are that “rural lending has become standardized across all financial agencies, with no innovation or adaptation to the special needs of the local population”, and that “lending has become politicized, with local politicians using poverty lending for extending patronage”.

It is, therefore, unsurprising that money-lenders and local landlords still play a leading role in the supply of informal credit despite charging high interest rates. This is partly because of difficulty in accessing formal credit, but also because of ties that can develop over time between those seeking credit and informal sector lenders (e.g. landowners or traders). Informal sector interest charges are as high as 100% per annum, compared with only 12–13% in the formal banking sector. However, the transaction costs associated with formal credit may mean that there is little difference in real cost between the two sources of credit.

Social capital

Despite official promotion, membership of self-help groups was found to be relatively low in all districts. Expansion in the number of self-help groups represents a major current initiative by government programmes. Self-help groups are designed to take into account the real needs of the poor through a multi-sectoral approach, with special emphasis on micro-credit and women as beneficiaries. Other perceived benefits associated with membership of self-help groups include support in cases of personal problems, access to information and better access to government services. However, functional literacy, skills and capacity building were only indicated as benefits by a few survey respondents, who also indicated that self-help group procedures and time requirements were constraints to their usefulness. Other problems included caste barriers, lack of awareness and domination of self-help group activity by certain individuals. In future it is important that in addition to savings and credit schemes, group promotion places more emphasis on technical skills and the development of market linkages (Adolph, 2003). Given the lack of critical mass of small groups, the creation of self-help group apex organizations also needs to be considered.

Infrastructure and physical assets

Most of the equipment owned for productive purposes is related to cultivation and includes ploughs, ox-carts and irrigation equipment. On the other hand, ownership of physical assets required for non-farm activities is distinctly small in the majority of the villages surveyed. This includes ownership of equipment such as flour mills, rice hullers and *jaggery* making equipment.

Infrastructure such as roads, electricity supply, access to markets and access to information were covered by the survey. With respect to roads, access as a whole is considered poor, partly due to insufficient maintenance of the existing road network. The negative impacts arising from

limited road access include both social components (limitations to access to education and health) and economic aspects (access to markets). Electricity was frequently mentioned as a constraint to both agriculture and the start of new non-farm enterprises. Villagers mostly complained about the reliability of the power supply. Although the infrastructure may be in place, shortage of power was frequently mentioned as a constraint to farming (e.g. for the operation of irrigation pumps) and post-harvest activities, such as threshing and milling. Many village businesses also reported that power was only available for a limited period of time per day. As a result, some owners of small enterprises have bought generators or diesel-powered equipment (e.g. threshers).

It is clear that a combination of capital assets is required for households to be able to diversify into non-farm livelihoods. In particular, human capital (i.e. skills and health) and access to finance tailored to the needs of micro- and small-scale entrepreneurs, appear important. Access to finance does not necessarily imply credit, since promotion of savings is often a more effective strategy, especially for the poor. Social capital in the form of networks and self-help groups plays a more important role for marginalized groups such as women and lower-caste community members. At the same time, a number of favourable exogenous conditions, largely beyond the control of households, need to be in place. These include good quality infrastructure, the existence of functioning markets (i.e. for services, goods and labour), and an economic environment that is conducive to enterprise development.

Employment and Income Patterns

An attempt was made during Phase I of the survey (i.e. PRA) to identify the different income generating activities in rural areas. This information was used in the design of the questionnaire section focusing on sub-sectors,

employment and income patterns. The questionnaire survey (Phase II) tried to capture data for all income earning household members regarding their sources of income (i.e. up to three sub-sectors) and the nature of their involvement in the sub-sectors (e.g. landowners or wage labourers). The households were asked for data on their current income (i.e. using 2001 as the baseline) and the past (i.e. the mid-1990s), so that any significant shifts could be discerned.

It is pertinent to reiterate here that though the same questionnaire and approach were used for data collection in both states, the different priorities of the local collaborators in the two states resulted in different analytical approaches. Hence, the income and livelihood data for the two states cannot be presented in the same format.

Madhya Pradesh

In Madhya Pradesh, data from PRA findings generated through village household lists and social maps, indicated that three out of eight villages surveyed have a high degree of non-farm employment (30–50%), whereas five villages show a lower level (10–25%) (Som *et al.*, 2002). This takes into account both full-time and part-time incomes from the non-farm sector.

The data presented in Table 6 indicate that the primary sector (i.e. mainly agricultural production) dominates the income sources of household heads and spouses alike. For small-scale and marginal farmers in particular, this is in the form of cultivation on the family farm and agricultural wage labour on larger farms.

The household heads that declared themselves as income earners have on average about 1.5 sources of income, that is, jobs during the year, both on-farm and off-farm. In 2001, according to the household survey, 49% of the household heads in Madhya Pradesh had an RNFE income source, but it needs to be borne in mind that these figures are not based on monetary values but simply on the basis of RNFE activities carried out during the year.

Table 6: Household members activities by sub-sectors in Madhya Pradesh (2001) (expressed as a percentage of all activities)

Sub-sector groups	Household heads	Spouses	Other male earners	Other female earners
Total respondents (number out of 799 households)	732	415	352	125
Primary production	102.5	136.6	109.7	131.0
Agricultural and food processing	5.6	2.2	6.5	7.1
Other primary processing	0.5	0.0	0.6	0.0
Traditional manufacturing	4.2	0.5	0.9	0.0
Modern manufacturing	20.6	5.8	12.8	1.8
Services	15.6	7.7	19.3	7.1
Other	2.7	2.7	2.3	0.9
Total RNFE	49.3	18.8	42.3	16.8
Total (all jobs/all sectors combined)	152	155	152	148

Source: Questionnaire survey (July 2002)

Note: RNFE includes agricultural and food processing, other primary processing, traditional manufacturing, modern manufacturing and services. Percentages can exceed 100% in one sub-sector group if individuals undertake several jobs (e.g. cultivation on the family farm, agricultural wage labour and collection of non-timber forest products (NTFPs)). The latter activity is common in Betul District, in particular among women.

Amongst those spouses that responded, each also has about 1.5 jobs. In the tribal areas, collection of non-timber forest products (NTFPs) is primarily a female activity. Otherwise spouses (generally women), have a considerably lower presence in the RNFE sector than men (i.e. 19% in total, for those members of the household who are income earners). Approximately two thirds of households in the tribal-dominated Betul District had spouses (women) that declared themselves as income earners (66%), whilst the corresponding figure was only about one third in Narsimhapur District (35%). This is explained by the greater gender equality found in tribal society than among other social groups in the rural areas.

Compared to the past (i.e. the mid 1990s), the extent of the RNFE has increased, albeit at a relatively slow pace. Amongst the income earning household heads, about 31% reported that they had income from RNFE sources in the past compared to 49% in 2001. For spouses and other male income earners, the corresponding

figures are 12% and 19%, and 27% and 42%, respectively. Only 17% of other female income earners declared that they had RNFE income sources in one form or another.

Amongst the different RNFE sectors, there are few that stand out as more important sources of employment. The construction sub-sector (i.e. building and road construction combined) provides employment for 17% of household heads but for the other main RNFE sub-sectors, including *jaggery* processing, trade, health and education, employment is below 5% of households. The health sub-sector is more significant as it provides employment for both men and women (4–5%).

The collection of income data proved to be difficult as households were often reluctant to provide specific information. However, the mean, net household income across the two districts in Madhya Pradesh is estimated at Rs 21,200 per annum, compared to a median of Rs

10,600⁸. Total average income of household heads is of the order of Rs 16,700, compared to a median of Rs 7200, whilst the average figures for spouses is Rs 4200, compared to a median income of Rs 2600. The median income reflects a more representative picture for the majority of households since means are affected by high relative incomes earned by a very small number of individuals.

Orissa

The current occupational characteristics of household heads in the two districts of Orissa are illustrated in Table 7, together with those in the past (again defined as the mid 1990s). These show that agriculture has been, and remains the predominant activity, but there are clearly diverging trends, since in Nayagarh, the importance of agriculture has remained constant, whilst in Bolangir, it has declined. A group of activities that relate to construction (brick making, masonry work, road construction, etc.) have become increasingly important in Bolangir, whilst in Nayagarh, bamboo and wood-based

activities, mining and manufacturing are significant, as well as construction. In both areas, natural resource-based activities have tended to stagnate or decline. Trading is an area of modest but growing importance in both districts. In Nayagarh overall, there has been relatively little change in shares between different activities, in contrast to Bolangir.

Certain activities, notably crop production and NTFP collection, are open to, and undertaken by all castes. In contrast, a significant number of other activities are constrained by caste boundaries, for example, those related to livestock and associated products (e.g. milk and dairy produce, goat and animal rearing).

The number of activities undertaken by household heads has increased in both districts of Orissa, a pattern that is also reflected in the activities of other household members. Growing diversification in Bolangir appears to be driven mainly by distress-push factors – given poor agricultural opportunities plus risk associated with the latter (also see above in relation to

Table 7: Major livelihood activities of household heads in Orissa (expressed as a percentage of all major livelihood activities)

	Bolangir		Nayagarh	
	Present (2001)	Past (mid 1990s)	Present (2001)	Past (mid 1990s)
Crop production	57	64	63	63
NTFPs	4	5	2	2
Bamboo and wood	2	2	9	10
Building and construction	24	20	7	6
Trade	6	4	4	3
Mining and manufacturing*	2	1	6	6
Salaried employment+	2	2	2	2
Other	1	2	7	8

Source: Questionnaire survey (July 2002)

*Mainly metal manufacturing.

+School teachers, government employees, etc.

⁸ In 1993–94, the poverty line was set at Rs. 205.84 per capita per month (i.e. around Rs 2470 per year) for rural areas and Rs 281.35 for urban areas (Mehta and Shah, 2003).

Table 8: Major livelihood household income categories according to sub-sectors in Orissa (Rs '000 per annum)

	Bolangir	Nayagarh
Crop production*	4.3–7.2	6.6–12.8
NTFPs*	0.7–1.1	2.0–7.0
Bamboo and wood products	3.7–7.5	5.0–11.0
Building and construction	5.2–7.1	5.0–13.0
Trade*	3.6–91.8	7.7–21.2
Mining and manufacturing	4.8–8.5	6.5–19.2
Salaried employment	8.5–42.0	20.0–70.0

Source: Questionnaire survey (July 2002)

*Activities undertaken by all caste groups.

landownership and small farm sizes). In Nayagarh, diversification also occurs, but the position is more mixed with both push and pull factors driving diversification.

Spouses' (wives) activities to some extent reflect those of heads of households but there are also some interesting differences. For example, in Bolangir, whilst agriculture remains the most important income generating activity for wives, the gap is smaller in relation to other activities. Instead, livelihood diversification is largely in further agricultural processing and livestock, and natural resource-based activities, especially NTFP collection. However, these two groups of activities show contrasting trends. Those relating to agriculture and livestock have increased significantly over time, whilst NTFP collection has declined.

Table 8 indicates the range of incomes earned across the four main caste categories for major livelihood activities in the two survey areas in Orissa. Recognizing that income data may be sensitive and that there are possibilities of mis-recording, conclusions need to be treated with caution. Nonetheless a number of points can be made. Overall, the table shows that incomes per activity are substantially higher in Nayagarh compared with Bolangir, tending to confirm the

assessment of relative resource endowment of the survey areas in the two districts. Amongst activities in each district there are a number which provide roughly similar income levels, that is agriculture and a number of RNFE occupations. A notable exception is provided by NTFPs, where incomes are much higher in Nayagarh. Certain activities (e.g. some types of trading and salaried employment), provide very high incomes for the few in a position to undertake them.

Overall, income disparity between caste groups tends to be highest in those occupations where there is a need for initial capital, for example, in terms of ownership of assets (which may have been inherited), or through human resource skills derived through education (e.g. in order to access salaried employment). These assets are most commonly found amongst members of the general castes.

Constraints on Non-farm Livelihoods

The main barriers to entry into the RNFE at micro-level identified during the course of the survey, include limitations to most factors of production, coupled with constraints on marketing and the business environment. Social and institutional constraints are also pervasive. Each of these areas is now considered in turn.

Inadequate credit facilities are the result of a variety of factors constraining access, for example, defaulter status and absence of collateral security amongst the marginalized, lack of information about credit sources, complicated bank procedures, and the prevalence of corruption. However, credit, especially that in the public programmes which often predominate, is often tied to specific areas of investment which are ill-suited to the needs and capabilities of recipients. Investments, therefore, often lead to default and potentially increased indebtedness.

Lack of market access includes the existence of 'predatory' intermediary traders blocking the flow of information on market prices and marketing opportunities, competition in the RNFE sector rendering it unprofitable for small entrepreneurs, lack of organized collective marketing, inefficient government *mandis* (i.e. markets), the existence of unofficial *mandis*, and inability to store products of the RNFE sector.

Weak/inadequate managerial capacities and skills to initiate a potential RNFE arise from the inability to undertake structured analysis of markets, unambitious RNFE planning which focuses on the village/cluster of villages as the target for RNFE promotion, low levels of education inhibiting employment possibilities, and a pessimistic attitude toward starting new enterprises, in particular amongst wage labourers.

Inadequate raw material supply, especially with respect to traditional RNFE activities, is related to depleting natural resources, and harassment faced by people during collection of such materials.

Weak infrastructure facilities in the case of roads stem both from inadequate initial investment and planning, and from subsequent lack of road maintenance that reduces accessibility. Inadequate power supply in Madhya Pradesh is partly due to the loss of a substantial source of power supply when Chattisgarh became a new state in 2002. In

Orissa, the principal problems arise from poor revenue collection systems which have knock-on effects in limited maintenance of power distribution networks, that as a result have become increasingly unreliable.

Market competition for traditional products manufactured in the villages arises from competition with 'modern' substitute products, due to quality issues, consumer perceptions and relative prices. This may include the production of foodstuffs (e.g. gulli oil) or manufacturing of traditional household goods (e.g. pottery, wood or bamboo items).

Caste and class barriers impact especially upon the marginalized preventing them from taking advantage of opportunities that may arise in the RNFE sector. Caste itself often defines which activities people can undertake, and lower castes are often excluded, especially in relation to food products consumed by upper castes. Upper castes are more likely to engage in successful RNFE activities because of better asset endowment, whilst at the same time trying to block access by the marginalized in the village to agents of growth, such as education, information and credit.

Weak business environments are common in rural districts and small- and medium-sized enterprise (SME) representatives pointed out that there is still a plethora of regulations and laws from before liberalization, which stifle the creation of new enterprises in rural areas. Growth in both the on-farm and off-farm sectors depends on a regulatory framework which is conducive to business at district level whilst protecting labour rights and environmental needs.

Conclusions: Sub-sector Overviews in Orissa and Madhya Pradesh

The potential for the RNFE can be illustrated by assessing the characteristics and constraints identified above in the context of measures which might result in more effective

development. This section briefly reviews such issues on a sub-sector basis. The sub-sector classification has been adapted from Fisher and Mahajan (1997) and the main categories of the classification include:

- (i) primary production (e.g. crop production, milk production, rearing of animals, NTFP collection)
- (ii) agricultural and food processing (e.g. *jaggery* making, *pappad bari* making)
- (iii) other primary processing (e.g. mining, *bidi*-rolling)
- (iv) traditional manufacturing (carpentry)
- (v) modern manufacturing (mechanical repairs, construction, etc.)
- (vi) services (e.g. trade).

In this study, the non-farm economy was defined as comprising sub-sector groups (ii)–(vi).

Primary production

A thriving agricultural sector is important for the development of a RNFE and agriculture continues to form the backbone of the rural economy. However, there are major differences between the two states. As mentioned above, the landholdings in Madhya Pradesh are larger than in Orissa, which has implications for the dynamics of the sub-sector. In Orissa, agriculture is relatively undynamic, and in Bolangir in particular, it appears to be a sub-sector in decline due to fragmentation of plots, poor soils, erratic rainfall and limited irrigation. Madhya Pradesh, on the other hand, has a stronger agricultural base and has proved to be dynamic in the past when it was able to respond to market opportunities and establish itself as India's leading soyabean producing state. Narsimhapur district in particular is renowned for its fertile soil and high yields, whilst Betul is a district with a large number of tribal households who tend to own farms. Nevertheless, agriculture in Madhya Pradesh is also undergoing change due to declining farm sizes (because of growing population density), decreasing soil fertility, and the effects of liberalization (e.g. increasing

competition on the domestic soya oil market due to imports). More diversification is required in the future (e.g. into horticulture, floriculture, maize and pulses), and irrigation will play an increasingly important role.

The collection of NTFPs is important for the inhabitants of tribal/forested areas (e.g. Betul District), where it often provides a seasonal second income. In particular, women are engaged in the collection and selling of products such as *tendu* leaves and *amla*. A major problem in many areas is the declining natural resource base as a result of encroachment on forest areas (despite protection measures that are theoretically in place). Whilst markets for some products remain strong, others are weak. In some locations (e.g. in Orissa), the continuing state monopoly in the trading of certain NTFP products results in relatively poor producer prices. Improved measures for conservation are vital, but difficult to implement. Cultivation of certain species for products with a high market value might also be considered to counter the diminishing availability of forest resources. There is also some scope for improving marketing, for example, through better group organization, value addition and more effective linkages to the national market.

Livestock ownership is generally limited, which may indicate scope for further development in the sector. For the poor, goat and poultry keeping are the most realistic options (cattle in any event may confine opportunities), but intensive cultivation in many areas may lead to conflicts with those producing crops. Common grazing areas are also increasingly becoming eroded, for example, in Orissa by encroachment both by the wealthy and the landless. Dairying development is feasible because of strong consumer demand for milk and associated products, but ownership of dairy cattle is more likely to be an option for the better-off. For all sectors, there is likely to be growing pressure towards intensive feed regimes and availability of feed is central to potential for development. In addition, consideration needs to

be given to the marketing of products, including competition from other states and countries.

Increased fish production can be promoted as a result of better water harvesting and management practices (e.g. small-scale dams and ponds). However, many existing water bodies that were communally held are being taken over by the rich, whilst others are being exploited for irrigation rather than fish culture. As with livestock, feed availability is a key issue and the logistics of supply of fish fry/fingerlings may also be problematic. The degree to which the poor can be involved in such an enterprise is likely to depend heavily on the extent to which effective local institutions can be developed, for example, to secure access to water bodies, to assure relevant inputs and to develop required expertise.

Agricultural and food processing

Processing industries in the survey areas have variable access to markets, and agro-processing overall was quite limited in Orissa. The overriding constraint in Orissa is the weakness of the agricultural sector which limits processing options, and often chronic poverty which limits local demand for processed products. Whilst *jaggery* making is thriving in parts of Madhya Pradesh and has an established market, production of *pappad* and *bari* was found to lack linkages with the wider market and the customer base at the village level is small. There are also social barriers which inhibit the use of the locally available, lower caste labour force, which in the case of food products can represent an absolute prohibition. A small number of grain mills were encountered and some mill owners have started to use diesel engines where shortage of power supply was reported as a major constraint to business.

Other primary processing

Very little activity was encountered in this sector in the villages surveyed in Madhya Pradesh although quarrying was of local importance in

Orissa. The sub-sector appears to be concentrated in pockets (e.g. mining and quarrying), however, it has potential due to the natural resource endowment in both states. Most NTFPs are confronting problems associated with a rapidly shrinking resource base as indicated above. Thus whilst in some instances there may be scope to improve value addition, raw material availability and quality are likely to constrain development. At the same time, the protection of workers is particularly important in this sub-sector, for example, in quarrying and *bidi*-rolling (also see Fisher and Mahajan, 1997).

Traditional manufacturing

This sub-sector is undergoing profound changes due to competition with 'modern' products (e.g. plastics), lack of raw material and mechanization. Some of the professions need assistance to make the transition to 'modern' manufacturing (e.g. traditional blacksmiths to mechanical repair, or carpenters making wooden agricultural implements to 'modern' furniture). For natural resources-based manufacturing (e.g. bamboo products), growing constraints on raw material supply require flexible policies which combine resource conservation with improved access, and which involve both manufacturers and the wider community. This type of intervention, whilst necessary, is likely to be difficult to implement because of caste and other social and institutional factors.

Modern manufacturing

Growing demand drives certain categories of this sector, such as road and cement-based building construction, mechanical repairs and manufacturing of metal products. Construction overall appears to be the most common and sometimes the most dynamic sector, even in areas where other economic sectors may be constrained (e.g. in areas of Orissa such as Bolangir). Mechanization of agriculture and other sections of the economy also plays a role. Other categories such as tailoring face competition from industrially manufactured products. Options to stimulate the sector include

the enhancement of the skill base, improved infrastructure, business support services and market linkages for those sectors that have potential. Linkages with the large-scale corporate sector can be encouraged on a selective basis (e.g. input supply from more rural districts).

Services

On a national scale, the service sub-sector (e.g. trade, transport, telecommunications, catering, tourism, education and health) is growing rapidly and has good prospects as a result of an expanding economy and rising incomes (also see Fisher and Mahajan, 1997). At the local level in Orissa and Madhya Pradesh, the picture is less clear. Whilst low entry requirements mean that the sector (in both rural and associated small

town locations) is accessible to the poor, including unemployed youth, margins and earnings are low because of the intense competition. In poorer rural areas, demand even for basic services is weak and the sector, therefore, has limited growth prospects. Thus it is the more dynamic rural areas (e.g. parts of Madhya Pradesh) that are more likely to have a thriving service sector. In the past, the public sector was a principal provider of opportunities for new entrants into the labour market; however, the reverse is now happening in the wake of liberalization. Despite these caveats, the tertiary sector as a whole has considerable potential for employment generation, if not for generation of substantial incomes.

The Need to Understand Rural-urban Linkages

Whilst much of the research under this project focused on village level issues, it is recognized that small- and medium-size towns surrounded by a rural hinterland form an integral part of the rural economy. In India, settlements with 5000 or more inhabitants are considered urban (provided they have a population density of at least 400 persons per square kilometre and at least 75% of their male working population is engaged in non-agricultural and allied activities). In many other developing countries, the population threshold used to distinguish urban from rural locations can be 10,000 or even 20,000 inhabitants. In these countries, economic activity that is carried out in relatively large settlements is, therefore, considered rural.

Irrespective of definitional issues, the need to consider small- and medium-size towns in studies of the rural economy and interventions aimed at developing it arises because much economic activity in these locations is closely interrelated with the rural hinterland, for example, through product, labour and financial flows. Furthermore, village households depend on, and interact with town centres in the pursuit of diversified livelihood strategies and activities. Finally, towns often offer an appropriate entry point for policy and investment interventions that target rural areas and households.

While generally benefiting from the growth of their hinterland, and the resulting expansion of local markets and surplus available for processing and marketing, rural towns can in turn

be instrumental in stimulating and sustaining an increase in economic activity and incomes in those areas. Their potential role in input distribution, financial service provision, agricultural processing, marketing and employment creation is noteworthy. They can also provide critical links to wider markets.

Yet small- and medium-size towns may fail to contribute to the development of the local economy, and may even exacerbate existing inequalities, as a result of excessive socio-economic polarization within local societies, inadequate institutional frameworks and policy failures at the macro-, meso-, sector- and micro-level (Hardoy and Satterthwaite, 1986; Douglass, 1998; Tacoli, 1998; Satterthwaite, 2000). Policies and interventions that promote integrated development of small- and medium-size towns and their hinterlands, whereby symbiotic roles are enhanced and negative linkages mitigated, must be based on a good understanding of the scale and nature of actual and potential inter-dependencies between rural town networks and surrounding areas, and between different locations along the urban hierarchy.

Small Rural Towns in the Local Economy

Urbanization levels and trends

An initial survey comprising 100 households in four villages of Bolangir district, Orissa, showed that village households engage in much more regular and intense interaction with block headquarter towns than with any other urban centres, including district headquarters and state

capitals (Wandschneider and Mishra, 2003). As a result, it was decided to focus research on the block headquarter towns. A formal questionnaire survey involving 183 enterprises was conducted in six towns – five block headquarters and one district capital (see Table 3 for selected towns). This was complemented by 30 semi-structured interviews with key informants in the private and government sectors in the same six locations. These differ in terms of proximity to other towns and size. Excluding Betul, which is a district capital with nearly 85,000 inhabitants, the populations of the other towns range from around 5000 to 23,417 inhabitants. Findings from the small rural town survey are summarized in Wandschneider (2003).

Madhya Pradesh and Orissa are overwhelmingly rural. Nayagarh has the lowest urbanization rate among the four chosen districts and in the whole of Orissa state, with less than 5% of the population residing in urban centres, whilst Betul has the highest of the study districts at around 20%. Despite low levels of urbanization, there is a clear long-term growth trend in towns in both Madhya Pradesh and Orissa: not only is the number of localities classified as urban increasing over time, but the population of most towns is also expanding at a faster pace than that of villages as a whole.

Despite these similarities, there are also significant differences across districts. In Betul and Narsimhapur (Madhya Pradesh), both the urban and rural populations are expanding and in both districts the overall decadal population growth between 1991 and 2001 was between 18% and 21%, respectively. In contrast, in Bolangir and Nayagarh (Orissa), the decadal growth of the rural population, which accounts for the bulk of the district population, was under 10%. In Orissa, urban population growth, therefore, seems to be occurring in the context of rural stagnation, and partly may be a consequence of lack of opportunities within the village economy, whereas in the two districts of

Madhya Pradesh economic opportunity may be expanding both at the village and town levels.

Economic activities in rural towns

Services, including trade and transport, constitute by far the most important area of enterprise activity in small rural towns, with nearly 75% of firms interviewed operating in this sector. The dominance of services in the town economy is even more pronounced than the data suggest since the survey did not cover public services such as administration, police, health and education. Some traditional and modern manufacturing firms are also present in the six study towns and over 20% of interviewed units operated in this sector. Manufacturing activity in towns includes pottery making, jewellery making, carpet weaving, brass utensil making, tailoring, carpentries, manufacture of leather shoes, and production of agricultural equipment and implements. However, the range of activity is usually fairly restricted, although in some locations a considerable number of people can be found in specific, often traditional occupations. Small towns generally host a fair number of professions linked to construction, often working as self-employed businesses, although some construction enterprises employ several permanent workers.

Surprisingly, the number of agro-processing units is generally limited, even though agriculture remains by far the main livelihood activity in surrounding areas. It is striking that no agricultural processing enterprise was found in three of the six locations. In the other towns, the type of agro-processing is a function of the major crops grown in the area, and includes rice, dal and flour milling as well as edible oil manufacture. One town also has a large dairy. The agricultural processing sector seems to be particularly vulnerable to competition from outside producers, for example, many dal mills in Odagoan and sugar factories in Chichli, Betul and Nayagarh (relatively close to both Daspalla and Odagoan) have closed over the past few

years. These firms were unable to compete due to problems in procuring good quality produce, relatively low levels of local demand, difficulties in accessing distant markets, and competition from outside sources of supply.

Profile of rural town enterprises and entrepreneurs

Micro and small units dominate the enterprise landscape. The typical town enterprise was established with an investment of under US\$ 5000 and generates an annual turnover of between US\$ 1000 and US\$ 10,000. Enterprises employ on average six workers, but in more than half of the cases, the workforce consists of less than two workers, often unpaid family labour. The largest firms are usually found in activities such as agro-processing, building or road construction, brick making, motorized transport and grain wholesaling. The scale of enterprise activity tends to increase in towns located within relatively prosperous agricultural areas because of greater availability of raw materials for processing and marketing and higher local demand for goods and services.

Given the nature of enterprise activity in the surveyed towns, it is not surprising that less than half have a telephone and that only one in ten has access to piped water. Even though over 75% of the enterprises are connected to the electricity grid, economic activity is often disrupted to a large degree by daily power cuts that may last for 4–6 hours. Agricultural processing and modern manufacturing activities are disproportionately affected by constant power cuts.

There is a clear gender pattern in the ownership of rural town enterprises. 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 both 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. In contrast, lower caste women contribute to household economic activities and engage in low-paid occupations, often on a seasonal and/or part-time basis, but they seldom take on a managerial role in enterprises.

The typical rural town entrepreneur is a reasonably well educated male, with an average of 12 years of formal education. 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 of the entrepreneurs interviewed decided to venture into business because they did not manage to gain salaried employment in government or the private sector.

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, ultimately enabling them to set up their own independent businesses. Fewer have received formal vocational training, which is often sponsored by government agencies, such as the District Industrial Centres and the Khadi and Village Industries Commission. Informal and formal training imparts specific technical skills, and as such was considered useful by almost all respondents, but it rarely leads to an upgrading of skills in areas such as marketing and management.

Whilst most entrepreneurs in the surveyed localities are Hindu, in towns in Madhya Pradesh, it is not uncommon to find Jains, Sikhs and Muslims well established in specific occupations. 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 limited and well below their representation in the population as a whole, signalling acute caste-based inequalities in asset distribution and access to economic opportunities. Scheduled castes that

own businesses are usually active in traditional, caste-defined occupations, such as the manufacturing of brass, copper and leather articles.

Over one-third of the surveyed rural town entrepreneurs own land. Average landholding size within this group exceeds 10 ha, which is relatively high in the local context, although there is considerable variation across respondents. Interestingly, for most land-owning entrepreneurs, agriculture is a subsidiary activity carried out on a seasonal and part-time basis, and some do not engage in farming at all. This seems to indicate that individuals with relatively significant landholdings are often able to diversify into non-farm enterprises which yield higher, more stable and less risky income than farming. Moreover, the fact that few landless entrepreneurs become involved in agriculture by leasing land or as seasonal wage labourers, also seems to suggest that such options are often inferior to running a small town enterprise.

Enterprise formation is especially high in the overcrowded retailing and petty business sectors, 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 these activities. Small-scale traditional manufacturing also entails low investment levels, thereby attracting a significant number of entrepreneurs, with skills often 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 a greater degree of risk-taking, are beyond the capacity of most entrepreneurs.

Linkages between rural towns and the local village economy

Employment linkages

Most businesses in the six study towns absorb little labour due to their small size. 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 9). Consequently, very limited wage employment opportunities are generated for households residing in neighbouring villages. The recruitment of labour outside the town is heavily concentrated in the few firms employing over 15 workers.

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. This 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 in the degree of specialization 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 take employment in town enterprises.

Small towns as market outlets

Small rural towns constitute an important market outlet for local village producers, with more than 20% of the enterprise units surveyed purchasing inputs from village households living within 25 km of town (Table 10). In addition, nearly 50% buy inputs within the town itself, and these are often produced in nearby villages. Evidence from 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 is agricultural produce 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 a co-operative society in

Table 9: 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 (<i>N</i> = 7)	43.7	54.1	0.8	1.1	1.1
Mining, manufacturing and construction (<i>N</i> = 42)	81.5	10.3	3.3	0	5
Services (<i>N</i> = 134)	82.3	17.3	0	0	1.3
Total (<i>N</i> = 183)	69.6	27.2	1.2	0.4	2.3

Source: Questionnaire survey (July 2002)

Table 10: Location of rural town 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 (<i>N</i> = 7)	86	86	57	57	86	0
Mining, manufacturing and construction (<i>N</i> = 42)	55	5	5	33	57	0
Services (<i>N</i> = 134)	43	23	2	31	53	0
Total (<i>N</i> = 183)	48	22	5	33	56	0

Source: Questionnaire survey (July 2002)

Table 11: Location of clients of rural town enterprises

	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 ($N = 7$)	43	29	86	29	86	143
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)

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 intermediate 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 characterized 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, such as pulses and grains (Gotegaon), soya and milk (Betul), handlooms (Patnagarh) and brass utensils (Chichli). In addition, business volumes in the leather shoe and jewellery sub-sectors (produced in Daspalla and Patnagarh towns, respectively) are relatively significant because a significant share of local production is channelled to outside markets.

Despite these examples, data on client location (Table 11) reveal that rural town enterprises in the study areas are much more reliant on local than outside markets. In addition, many businesses selling to non-local markets have limited or no backward production linkages to the local village economy, as in the case of modern manufacturing industries in Betul, leather shoe and carpet making in Daspalla, and jewellery making in Patnagarh. It is also the case of motorized transport businesses, which often have a customer base beyond the local area, and

construction firms, which frequently 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 entrepreneurs in towns 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 limited range of designs to traditional weavers. Contractors of brass utensils in Chichli have neither the capital nor the necessary 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 little product innovation is taking place, through the introduction of decorative stitches, for example.

In sum, the surveyed towns seem to be playing a relatively limited role in linking the village economy to downstream markets. As discussed below, a poor business environment and a weak local entrepreneurial base limit the potential role of rural towns as intermediary market centres. It should also be noted that the rural town and its enterprise sector do not evolve in isolation from developments in the hinterland economy and other urban locations. 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 ability of smaller towns to attract investment and compete in the wider market place (e.g. Jabalpur near Gotegaon, Kantabanji near Patnagarh and Gadawara near Chichli).

Small towns as distribution centres for imported goods

Small rural towns rely on outside input supply sources to a much greater extent than local sources (Table 10). About 30% purchases inputs from towns or cities situated within 50 km and over 40% 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 addition.

Imported goods often pose no threat to existing local production and sometimes are even critical to certain economic activities, not only within town but also in surrounding villages. For example, artisans such as weavers, jewellers, leather shoemakers, 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. However, certain imported goods can undermine the competitiveness of village level production, 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. 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.

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 unsophisticated 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.

Constraints on 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.

Many respondents had some difficulty in identifying ways in which the wider economic context impacts upon their business. This difficulty arises because very small firms employing few or no workers, using simple technologies, and catering for highly localized markets generally have limited growth potential irrespective of the policy, regulatory, institutional and infrastructural environment. The scope for expansion is limited even where local incomes and demand are rising, since the activities developed are usually characterized by low entry barriers, thus as profits increase so does the number of competing firms.

It is also important to stress that the analysis is centred on the constraints experienced by existing enterprises. Given that constraints and needs vary across activities and enterprises, more detailed information is required for effective targeting of specific sub-sectors. Opinions are also only a reflection of the existing enterprise structure. For example, the views of entrepreneurs operating in the service and traditional manufacturing sectors are much better represented than those of agro-processing firms. A sub-sector focus would be required to overcome this bias.

Leaving aside these caveats, intense competition was the most cited constraint to business development, with 60% of responses, whilst low and stagnating demand is of special concern to many units in the traditional manufacturing sector (Table 12). These enterprises are exposed to strong competition, both in local and more distant markets. Locally, producers of non-tradable goods and services (e.g. barbers and local transport service providers) compete with other local suppliers, whereas producers of tradable goods and services (e.g. weavers and carpenters) face competition from both local and outside sources. Businesses which rely on distant

Table 12: 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)

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

Nearly 45% of respondents viewed *poor access to finance* as a constraint to the development of their business. Personal funds constitute by far the most common 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 mentioned earlier, inadequacies in the

power supply system, characterized by chronic shortages and voltage fluctuations, are particularly problematic for 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, and the fact that only 18% of firms surveyed reported paying taxes is revealing. However, India is renowned for having a complex and largely ineffective regulatory policy system which discourages enterprise modernization 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 to the external environment under which town enterprises operate (policies, regulations, institutions, infrastructure, agricultural surplus, etc.) certainly provide the most effective path towards the development of enterprise activity in a given area. Still, enterprises can also benefit from interventions which address internal constraints. Survey

Table 13: 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)

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 13).

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 localized 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 business 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% 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, and whilst 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 relatively scarce.

Over 30% of respondents felt the need for support in recruiting *skilled staff*, which suggests that at least for some activities there is a restricted supply of relevant skills. It is surprising, therefore, to learn that a much smaller number regarded *vocational training* for employees as relevant. One possible explanation for these apparently contradictory views is that trainees might be absent from the workplace for a considerable time period. The lack of reputable training service providers may be another contributing factor.

Approximately 30% 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 at 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 for 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. 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 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.

Conclusions

Small rural towns in Madhya Pradesh and Orissa 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' (i.e. sales to distant markets) on local economic development is particularly significant when the benefits are distributed over significant segments of the rural population and translate into increased demand for locally produced goods and services. This issue was not fully explored in the survey, but there are several indications that at least in some cases 'exports' may not be contributing much to the development of the local economy. 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 characterized by low and declining returns. Leaf plate making constitutes another example of an exporting activity which generates critical but very low and seasonal income for poor women in some forest pockets. In contrast, significant sales of grain, soyabean, pulses and milk can inject significant income into the local economy and generate considerable demand for agricultural labour, production inputs and consumer goods.

The importance of 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 such producers are linked to town enterprises for accessing raw materials, credit and/or other support services. Examples of such linkages were found during the fieldwork, but there is potential for strengthening these processes, even in areas characterized 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 towns.

Rural towns are clearly failing to create significant wage employment opportunities for the population living in surrounding areas. Town firms rarely employ workers from nearby villages as a result of their limited labour absorption capacity and poor local transport links. Rural 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 involving 'low-return' activities. Nonetheless, the latter often generate greater returns than farming, and provide a more stable source of income throughout the year for the entrepreneurs involved.

There are a number of reasons why local entrepreneurs may prefer to locate in towns rather than villages. First, rural towns have wider catchment areas than villages, therefore enabling the development of activities such as trading in agricultural inputs, retailing of consumer goods, repair services and construction. Second, they constitute a suitable operational base for activities which benefit from the regular movement of goods and people, such as transport services, restaurants and hotels. Third, even though much artisanal manufacturing activity is based at village level, there is evidence that some traditional and small-scale activities are attracted to small towns, where artisans can enjoy easier access to imported inputs and outside markets; shoe and jewellery making are two examples. Finally, improved access to local raw materials and outside markets provides some scope for scaling-up wholesaling and processing activities. Clearly, 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 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. Size considerations aside, a poor agricultural base and competition from suppliers in other locations within or outside the district, may also inhibit the development of processing activities at the block headquarters level.

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 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 – rather than radically alter – economic and social dynamics at the village level.

National Legislation

In 1993 the National Parliament in India passed the 73rd and the 74th amendments related to establishment of local governments in rural and urban areas, respectively. These amendments contained some provisions that were mandatory while others were of a discretionary nature. Mandatory provisions were to be incorporated into the state act as such.

The discretionary provisions gave choices to the state governments, for example, the extent of powers that could be given to the different levels of the Panchayat. Each state government has adopted the discretionary provisions to varying degrees in their state acts. The different use of these provisions has implications for how institutions function; and the combined implementation of mandatory and discretionary provisions will determine the overall effectiveness of these institutions of local governance. Therefore, two principal questions addressed here are:

- Has the varying use of the discretionary powers by the states created structures which make a significant difference in the way local communities participate in local governance in the two states? – this question is fundamental because the level of representation and empowerment of the constituency largely determine the extent to which local government works for the community
- Do the powers and functions devolved under mandatory and discretionary provisions enable the PRIs to promote local

development, particularly rural non-farm economic development?

Use of Discretionary Powers by the States

It is mandatory on all states to create a three-tiered structure with local government institutions or Panchayats at district, block and village levels. Discretionary powers have been used by both Madhya Pradesh and Orissa to devolve more power, functions and responsibilities to the village community than is required by national legislation through the creation of an additional layer at the village community level. The states have also used discretionary provisions to distribute power to the three statutory levels in different magnitude.

Power to the people

State legislations in Madhya Pradesh and Orissa created the fourth layer at community level. In Madhya Pradesh, it is referred to as the Gram Sabha and in Orissa as the Palli Sabha. Madhya Pradesh devolved some of the powers and functions from the Gram (village) Panchayat to the Gram Sabha. It also created eight standing committees in each village to carry out the functions devolved to them. This was in addition to the three standing committees under the Gram Panchayat. Similarly in Orissa, five additional standing committees were created to support the Palli Sabha.

Our survey and analyses at the village level show that in Madhya Pradesh, where state legislation has given substantial powers and functions to the

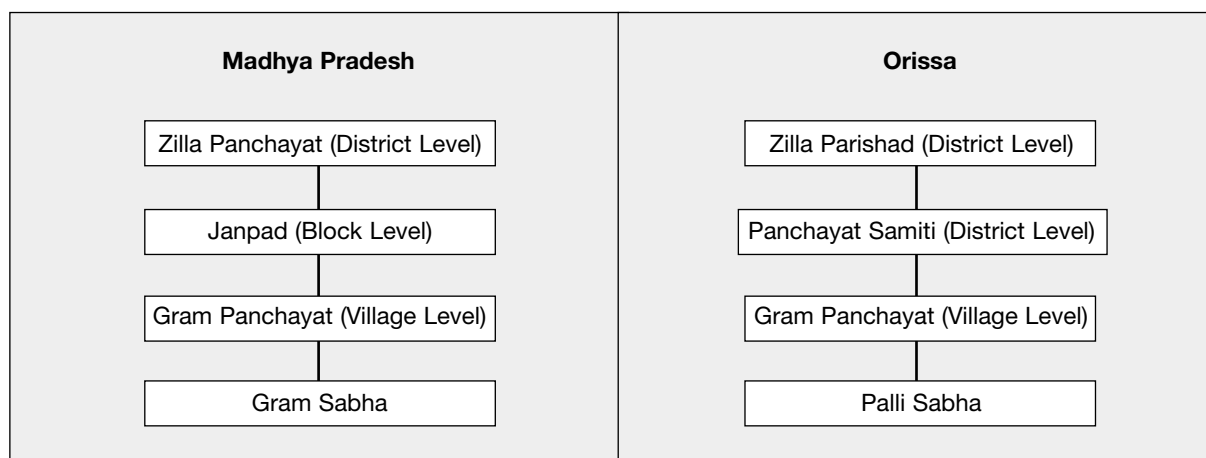


Figure 1: The Panchayat Raj Institutions in Madhya Pradesh and Orissa

Gram Sabha, there remains a number of issues for consideration:

- there is considerable confusion among the villagers as to the designated functions of the various committees
- individuals are members of a committee without being fully aware of its functions, role, responsibilities and affiliation (PRI committee or project-based committee)
- a multiplicity of legislations bringing in change has added to the misunderstandings
- Gram Sabha meetings are called at short notice making it difficult for individuals to attend
- there is little feedback from the *Sarpanch* (Head of Gram Panchayat) on the outcomes of meetings.

Consequently, the participation rate of the community in local democratic processes has declined and is almost negligible leaving the *Sarpanch* and the Secretary to take most of the decisions.

In Orissa, the survey shows that the village level committees have yet to be set up so the decision-making is left to the *Sarpanch* and the *Naib* (Deputy)-*Sarpanch*.

This loss of confidence in the local representatives in Madhya Pradesh and delay in setting up the village-level institutions in Orissa

are unfortunate. Given that in both states the participation rate in the local elections in 2000 was between 85% and 93% (household survey data), most of the community feel let down by the current situation. Further to this, and according to our survey, nearly 40% of households in Madhya Pradesh and about 30% in Orissa feel that elected representatives have too much vested interest to work for the people.

Social relations and lack of empowerment

Empowerment of individuals and communities can take place through: (i) improved representation in political systems; and (ii) higher accountability between leaders and their constituency through greater awareness of rights. The institutional assessment in Phase I examined the membership profiles of all Panchayats. It shows that at all three levels women, the scheduled tribes, scheduled castes and other backward castes are represented as required by national legislation. However, our findings show that this does not improve representation at higher levels, whilst the reasons for this varies with the socio-political and economic structure of the district.

Representation

In Madhya Pradesh, in Narsimhapur District, all caste groups are well represented and the local economy is grounded in agriculture. The

common response of the traditional power groups to the emergence of the PRIs is that of co-option. This co-option is either through becoming members of the new institutions themselves or by backing a certain candidate in constituencies which are reserved for the socially disadvantaged groups. In the first instance, there is no dilemma in accountability as the elected member represents the interests of his/her community. In the case of the latter, where the leader has been co-opted by providing the initial support to run the election campaign, it means diminished accountability towards the constituency, which is socially and economically deprived. Consequently, the source of power in this district still lies in the traditional mix of upper caste, higher economic class and/or landholders (potential to provide employment to others).

Betul District of Madhya Pradesh is less heterogeneous and dominated by tribal communities. The rural economy is forest-based with long-term, long distance migration, which means that village leaders have limited control over households (since the latter are often dispersed and household members may not be present due to migration). Literacy and political activism have allowed the elected representative from the scheduled tribes to achieve leadership of their community and some degree of empowerment. This democratic structure has taken root more easily where the previous power relations were not tied to economic controls. However, it was noted that at the district and block levels, these representatives find it hard to work independently as the traditional power groups have strategic influence and higher capacity to deliver.

In Bolangir and Nayagarh Districts of Orissa, the elected representatives from the scheduled castes and tribes are virtually excluded from participation and discussions in the Gram Sabha and Palli Sabha. The traditional power groups (upper caste and landowners) use the social barriers of untouchability and caste-distance to

ostracize leaders of minority groups at Panchayat meetings (i.e. forcing these leaders to sit on the floor at the margins of the gathering or refusing to let them join the other elected members at the table). To avoid social humiliation, these leaders stop participating in Panchayat activities, which effectively leaves decision-making in the hands of the upper castes and landowners.

Awareness levels

Knowledge of local institutions and the rights they bestow are an important source of empowerment. Our survey findings show that in Betul less than 3% of the people are aware of the role and functions of the Gram Sabha and Gram Panchayat (Table 14). This awareness is positively correlated to landownership (0.34) and household income (0.21); but less strongly related to household's level of education (0.19). In Narsimhapur, the majority are somewhat aware (53%) and 19% are fully aware of the role and functions of the Gram Sabha and Gram Panchayat. Overall, 63% of all upper caste members in the two districts of Madhya Pradesh are somewhat aware of the functions and responsibilities of the Gram Sabha and the Gram Panchayat. They argue that "there are no (government) programmes for us, so we have to know the system to get a share of funds coming to the village".

In Orissa, the district of Bolangir was selected as it represented a drought-prone, marginal district with high levels of poverty. In this district the levels of awareness of the Gram Panchayat and how it functions are higher (33% fully aware) than Nayagarh (25% fully aware). About 15% of the people in Bolangir are somewhat aware of its functions, and of the functions of the committees; whilst in Nayagarh only 6.5% are somewhat aware. This could perhaps be explained by high level of donor and NGO activity in Bolangir relating to awareness raising, training and skills development, information dissemination on availability of credit, rural livelihoods development and improved watershed management.

Table 14: Peoples' awareness of the Gram Sabha as an institution (% of households)

Level of awareness	Madhya Pradesh		Orissa	
	Narsimhapur	Betul	Bolangir	Nayagarh
Of the overall role of the Gram Sabha				
Not aware	24.7	59.7	21.3	24.0
Somewhat aware	53.2	37.6	46.0	50.6
Fully aware	18.7	02.7	32.7	25.4
That it has been created by legislation				
Not aware	43.0	86.0	54.5	75.8
Somewhat aware	26.3	11.3	30.8	18.3
Fully aware	21.1	02.7	14.7	5.9
How it functions				
Not aware	34.4	87.2	39.0	51.2
Somewhat aware	45.6	09.8	47.7	36.8
Fully aware	20.0	03.0	13.3	12.0
Functions of the Gram Sabha				
Not aware	45.6	86.6	33.5	57.3
Somewhat aware	38.4	11.6	50.8	31.7
Fully aware	15.7	01.8	15.7	11.0
Functions of committees				
Not aware	66.0	91.1	50.2	76.0
Somewhat aware	24.5	07.3	38.8	19.3
Fully aware	10.0	01.6	11.0	4.7

Source: Questionnaire Survey (July 2002)

Distribution of power among district-, block- and village-level institutions

It was important to look at the distribution of power to identify the appropriate agency for intervention in support of the RNFE and local economic development. Examination of the two important functions of institutions at all levels revealed that the true centre of power has not changed with greater discretionary devolution to the community. The two functions are: (i) preparation of annual plans and budget; and (ii) re-allocating funds made available by the central and state governments to the lower levels of the hierarchy.

The findings show that:

- although the Gram Panchayat and the Gram Sabha/Palli Sabha select the projects and

beneficiaries for the different Centrally Sponsored Schemes (CSS), they are strictly constrained by the monies allocated to them by the District Panchayat, whose Chief Executive Officer is appointed by the government, and is generally the District Collector (a civil servant), and by the District Rural Development Authority's (DRDA) choice of activities to be promoted in a particular district under the scheme being implemented

- block-level bodies are merely the channelling agencies of the village-level plans forwarded to them; they consolidate the plans and forward them to the district-level institutions
- the budgets submitted by the Gram Panchayats can be changed at this level; the final decisions about funds, projects and schemes are with the District Planning

Committee (DPC), who can, and do override, the recommendations of the District Panchayat, the elected body. This is possible because the DPC has greater administrative influence than the District Panchayat. In both Orissa and Madhya Pradesh, the DPC is headed by a Minister of State (generally a regional leader) nominated by the state government, with the District Collector as the member Secretary

- the DPC has considerable financial and administrative powers over line departments and their functionaries
- disbursements of funds transfer directly from the District Panchayat to the Gram Panchayats and/or Gram Sabha
- block-level institutions are the implementing arm for projects implemented by the line departments; our study shows that the dominant players at the block level are the functionaries of the line departments.

Panchayat Raj Institutions, Promotion of Local Development and Impact on the RNFE

The second principal question addressed by this study is whether the local government institutions have been able to promote local development⁹ and whether they have had any beneficial effect on the RNFE by enabling forms of supportive governance; and what role can they play in any future intervention. The findings are summarized below.

District-level institutions and promotion of local development

There are a number of reasons why these PRIs are limited in their ability to initiate any substantial change. Despite the wide ranging powers given to the district-level authorities, they work within the confines of the CSS and projects. The developmental focus of these

schemes is narrow and sub-sectoral, with a lack of attention to issues of markets and marketing of produce. Initiatives under these schemes are limited in their perspective as they envisage only small increases in income to raise households above the poverty line. Special schemes for supporting small-scale village and household industries, still concentrate on traditional items for which the market has declined following changes in consumer preferences. Most CSS are founded on small-scale improvement, with little scope for scaling up. They also emphasize employment generation, income creation and alleviation of hardships. While all these objectives are important, such schemes do not provide an impetus to local economic growth.

Additionally, the funds disbursed to these institutions prescribe the activities and target groups for the scheme as a whole. As such it may not be appropriate to the whole district. However, neither the DRDA nor the members of the DPC, show any initiative to differentiate needs and capacities below the district level. While the Directors of the different DRDAs admit the need to identify new markets and new products, few attempts have been made to identify emergent sectors to promote. They critically recognized a lack of expertise at the district level to undertake such an initiative. In the four districts studied, none had initiated any significant change in activity in the last 5 years.

Theoretically, the block-level institutions and particularly the Block Development Officer (BDO) are the main agents for delivery of rural services. However, our analysis shows it is the weakest strata in the hierarchy. The BDO, a government appointee, is a low level functionary with limited human resources capability. There is considerable literature noting the lack of co-ordination in the activities of different line departments, and the consequent low impact of schemes and slow pace of change in rural areas. Technically, the BDO is placed to help improve co-ordination of schemes and activities of line

⁹ The term local development is used to imply expansion of economic activities, increase in productivity, improved infrastructure, more diverse livelihood opportunities and options and an overall improvement in the social and economic well-being of the local population.

departments at the block level. However, as a low ranked functionary, the BDO is not automatically advised, and has no prior information from the line departments of their schedule of activities. Furthermore, although he has the authority to ask for it, the BDO feels unable/hesitant to do so.

The system of reservation (though desirable from an equity point of view) can have adverse effects on promoting long-term development. The seats held by women and members of other backward castes are allocated by rotation among different constituencies. In practice, this implies that a woman or a scheduled caste/tribe elected to a Panchayat will normally have a term of 5 years, with no prospect for re-election. This does not encourage a long-term perspective to development. Short-term perspectives and self-interest dominate, with little concern for the community at large.

Local representatives are poorly informed of their functions and responsibilities

The ability to function effectively for the people depends partly on how well informed the local representatives are of their own powers and responsibilities; and partly on whose interests they represent (this has been discussed above). Interviews with representatives from all levels of the PRI show that the majority is unfamiliar with the role they are expected to play. At the district level, the members hardly participate in the process of planning and fund allocation under the CSS. Most seemed unaware of the procedures and regulations. Consequently, the functionaries are able to bypass them and limit their function to rubber-stamping. A similar situation exists at the block level.

At the village level, an important power devolved to the Gram Panchayat is the right to levy tax on property, business, markets, fairs and for the service provided, for example, street lighting or public toilets, among others. However, only a small number were aware of this fiscal power.

Further, there is considerable confusion among the elected members as to what functions the different committees under the Gram Panchayat are expected to perform. Again, the members have made little effort to inform themselves.

Three reasons explain the situation. Those elected members who represent the traditional power groups rely on the old, established links to serve their requirements, and as such they do not see the need to be involved in administration and governance. Secondly, a large number of elected members are not interested in good governance, since they see politics as potential enterprise for economic gain. Thirdly, for those who may be interested, the large number of amendments through which power has been devolved, makes access to such information complex. Thus, the body of elected members has not really contributed to improving governance or promoting local development.

Overwhelming dependency on government funding

A review of money received and 'own source' funds shows the overwhelming dependency of PRIs on government funding. The use of most of these funds is not audited and as such they are often a source of corruption. The availability of these funds also discourages any effort to generate local revenue. Tables 15 and 16 show the actual funds received by the PRIs in Narsimhapur District. Similar data for Betul, Nayagarh and Bolangir Districts were not available.

Reluctance to use its fiscal powers

None of the Gram Panchayats studied used their fiscal powers to levy new taxes. This trend is also noted by Girglani (1994) and Vyasulu (2003). The argument given by the Panchayat members in Madhya Pradesh and Orissa is that it is difficult to levy taxes on your own constituency, especially when you live in the community. In

¹⁰ For detailed discussion and list of taxes that Panchayats can levy in Madhya Pradesh see Dasgupta *et al.* (2002). For a wider discussion see Girglani (1994).

Table 15: Funds available to Gram Panchayats in Narsimhapur District, Madhya Pradesh, by block (actual amount received in Rs)

Receipts	Jhoteswar (1988–99)	Manegaon (2000–01)	Thalwada (2000–01)	Batesara (2000–01)
Own source	Nil	Nil	Nil	2594 (1%)
Funds from the State Finance Commission, Centrally and State Sponsored Schemes	497,027	211,844	487,851	229,172
Total	497,027	211,844	487,851	231,766

Source: Collected by the study team from records made available by Gram Panchayats

Table 16: Funds available to Janpad Panchayats and Zila Panchayat in Narsimhapur District Madhya Pradesh (actual amount received in Rs)

Receipts	Janpad Panchayat Chichli block (2000–01)	Janpad Panchayat Gotegaon block (1999–00)	Zila Panchayat Narsimhapur District (1999–00)
Own source	2,350,356 (16%)	390,034 (3%)	1,615,192 (0.71%)
Funds from the State Finance Commission, Centrally and State Sponsored Schemes	11,541, 621 (84%)	14,229,292 (97%)	212,500,040 (99.29%)
Total	13,891,977 (100%)	14,619,326 (100%)	228,652,324 (100%)

Source: Collected by the study team from the respective PRIs

reality, PRIs can provide services, but these would generally benefit the poor, which is of little interest to the better-off (i.e. those exerting power within the new system).

As seen above, a considerable amount of funds flow to the PRIs from government. The PRIs often act as contractors for such projects, thus providing scope for enrichment of Panchayat members. Further, the PRIs tend to reduce their dependency on internal resources such as taxes, revenue from common pool resources, etc., and instead try to mobilize funds from outside, as people are less likely to request a social audit (i.e. accountability of PRI) if they are not asked to pay taxes.

Limited cognition of how to generate and manage own income

Interviews with Panchayat members showed that few had any clear vision for increasing their own sources of income. The lack of interest could be partly explained by the reasons discussed above (i.e. local politicians still expect the state government to collect tax and then transfer the revenue to the PRI).

Village Panchayats: their focus of activity

The Gram Panchayat and the Gram Sabha focus on developing small-scale infrastructure (e.g. village roads, culverts, cleaning local water bodies) projects and other facilities in the village under Employment Assurance Schemes, where

they have demonstrated their capability to execute such projects. However, these projects are chosen on an *ad hoc* basis for employment generation with little or no systematic planning on an annual basis. With some planning, annual construction on a more systematic basis could have a cumulative effect and lead to some overall improvement in village infrastructure. However, since the aim of the schemes is employment generation, such a perspective has not been adopted by the PRIs.

Survey data from Madhya Pradesh and Orissa show that only 8–9% of households think that PRIs have had any positive benefit on rural economic activity. Whilst Panchayat activities include some that directly impact upon economic activity, for example, promotion of agricultural and other marketing activities, and improving access to NTFPs, these generally promote wage employment rather than, for example, infrastructure to improve production and marketing more directly. Other areas where some impact is felt cover social and service functions, notably welfare support, nutrition and health care. The latter arises in the range of Panchayat committees that interface with government programmes and schemes. Overall there is little sign of activities assisting resource management and marketing, and effects on the RNFE are negligible. Furthermore, the PRIs are perceived by the people as having only a welfare role. Thus, the lack of involvement in promoting economic activities is reinforced by people's perception of PRIs as welfare institutions.

It is important to note that Panchayat members do not see generating employment and improving economic opportunities as part of their role, although considerable power has been given to manage local natural resources. The promotion of economic development is considered a function of the government, more specifically of the line departments. Co-operatives, some NGOs and a few self-help groups are involved in expanding economic activities, these are more active in some districts, for example, in Bolangir, than in others.

The role of village-level committees

There are a wide range of committees operating at village level. However, only 5% of the community in Orissa and 6% in Madhya Pradesh participate in these committees. The majority of households (70% in Orissa and 80% in Madhya Pradesh) consider themselves to be unaffected by committees' operations or perceive any benefit from them. One key reason is the minimal resources generally available to specific committees. Secondly, most villagers reported that they felt they had little control over the decision-making or activities of the Gram Sabha committees. These committees have, therefore, had little direct effect upon economic activity, including those in the non-farm sector.

District level and below: limited economic perspective

Overall, there is a lack of an integrated approach to management of local economic development at district level. The PRIs do not consider it their role nor do they appear to have the capabilities for understanding economic issues and analysis, nor for promoting wider economic development. The CSS, the main vehicles for development, generally focus on small-scale income generation and employment and on alleviation of deprivation. They are sub-sectoral in approach, concentrating on small-scale improvements in production, crop management and protection. Such an approach leads to a patchy pattern of change rather than cumulative change. The functionaries, now part of the local government institutions, are preoccupied with targets rather than in effecting real change in production patterns and productivity. The vision and expertise necessary to identify emergent sectors, new markets and products are absent at this level.

Panchayat Raj Institutions and Line Departments

This study underscores some of the findings in other studies in India which show that line

department officials generally tend to ignore the elected members. Decentralization in both Madhya Pradesh and Orissa also included administrative devolution. Administrative decentralization involved transfer of functions and functionaries from the state sector to Panchayats sector with the aim of facilitating and strengthening the PRIs. This study shows that the government officials continue to exercise more power over decision-making than elected members by limiting information sharing and by minimizing the role of the District Panchayat to that of rubber-stamping.

The allegiances and loyalties of these officials remain with their departmental line managers to ensure career progression. Manor (1995) has noted that authority to discipline should move to the local authorities. The state act in Madhya Pradesh has tried to address this by shifting some of the control of the reward system to the District Panchayat, but this is not working because elected members are not aware that this power has been devolved to them. This underscores the need to change the attitudes and motivation of both bureaucrats and elected members.

Other Institutions and the Rural Non-Farm Economy

Other institutions operating in villages were also studied to assess the role they play in the rural economy. These are: (i) traditional institutions based on caste/tribe lines; (ii) project or scheme-based institutions or committees; (iii) co-operatives; (iv) civil society organizations; and (v) self-help groups facilitated by banks, NGOs, government schemes and donor projects.

Traditional institutions, user committees, co-operatives and NGOs

The traditional institutions have a high degree of acceptability within the community, but they have closed membership, are influenced by caste dynamics and no longer play a significant economic role. The project-based institutions are resource-rich, but are bound by their own objectives and are

directed by project officials. Committees have been formed under different government schemes and donor-aided projects. They are involved in work such as forest protection, improving access to clean water and better sanitation; enabling self-help groups to generate income, usually in the non-farm sector; management of schools and overall education programmes in the village. The civil society organizations have the information and the capacity to facilitate, but they are not linked with each other or any other organization. Each operates in the space that they have created in village society.

Most of these institutions are formal in nature and have clearly defined objectives. But there is a lack of convergence in the functioning of these institutions. Neither do these institutions share their plans and objectives with other institutions nor do they pool resources to create synergies in the village. In some cases the institutions have been found to duplicate the work of the PRIs (e.g. project committees). They all work independently, with no formal links with the PRIs. There is a clear lack of complementarity and wastage of resources. Our study showed that about 70% of the households were totally unfamiliar with the role being played by the different actors/projects.

This implies that the life of these institutions and the benefits that accrue to members are limited to the lifetime of the project. It is necessary to develop links with the established local government institutions to ensure sustainability. However, there is a fear that a certain amount of independence will be lost if links are made with government institutions. The lack of accountability in the PRIs is an additional factor.

Self-help groups

As in the rest of India, an increasing number of initiatives are working through self-help groups in the study area in both states. The higher profile of self-help groups and the greater involvement of people in their activities stem from their wider ranging mandate, availability of resources and more participatory approach in their operation. Self-help groups have become a popular

instrument for development as they are expected to reach the poorest of poor. However, it is generally accepted that self-help groups often do not include the poorest of poor, as they are generally socially marginalized, can mobilize few resources of their own, and/or do not have enough savings to join. Moreover, the intrinsic bias of implementing agencies makes it difficult to reach them.

Members of these groups have taken up non-farm activities. However, they are not always sustainable as they do not receive adequate and/or timely advice from line departments; for example, goat rearing is a popular option, but there is high mortality rate among the young animals as veterinary advice is not always available.

Banks

Nearly 60% of the community felt that banks had made the highest contribution in developing non-farm activities. NABARD, the apex bank for rural micro-finance, has for the last decade been promoting non-farm activities. However, its impact has been limited, as access to formal credit is constrained by the need for collateral; is conditional on a clean record of repayment; and comes with considerable paperwork, often beyond the capability of small borrowers. Our survey data showed that few households have a clean record of repayment, even if they could provide collateral, having defaulted at some time or the other. This makes most poor households ineligible for formal credit.

Crowded Institutional Space at the Village Level

This research has shown that there are a large number of actors who have invested at the village level to initiate change and growth. They tend to rely on the project-specific user groups to implement their objectives. This implies that the benefits accruing from these projects are limited to the lifetime of the project. However, sustainability could be enhanced if these projects developed links with the local government institutions. This raises the question as to who

would be the best partner for local development, the PRIs or the user committees promoted by line departments and external donor projects?

There is conflicting theoretical and empirical evidence on this. Those who support user committees as partners in development argue that a multiplicity of committees is a means for getting more benefits from government. Furthermore, villagers see this as an opportunity to ensure the development of their villages through the involvement of a large number of government departments. The bureaucracy too favours these committees, as they are able to have a greater say in the implementation of their programmes through these committees. Moreover, these are more amenable to bureaucratic controls than the PRIs. Committees also create a broader leadership base and provide an opportunity for more people to be involved in decision-making through membership.

Moreover, user committees can focus on the group/project's objectives and can deliver better results. It is expected that in the long run, members of these committees would seek greater power and opt to stand for election to the PRIs. Currently, the user committees and other parallel institutions are considered imperative for ensuring greater participation by the local community.

Those who advocate the involvement of the PRIs argue that benefits of projects dependent on user committees are short lived and are not sustainable beyond the life of the project. The livelihoods base of the poor remains only marginally improved. Some social capital may be created through awareness-raising, but evidence shows that most of this social capital is held by the rich, leading to further entrenchment of their powers. Though NGO involvement may extend the benefits to the poorer groups, there is no guarantee that this will happen.

Empirically, our study shows that nearly 89% of households think that neither PRI committees nor user groups are considered functionally effective. In Betul District, opinion is split as to who would be the better partner in development projects,

with 4% support for each group. In Narsimhapur District, 35% think that the Gram Sabha committees are the more appropriate partners as against 23% supporting user groups. In Orissa, the community on balance favoured by a small margin the user groups to the PRIs. These results show that there is no obvious trend or support for one or the other. Clearly the opinions of the communities reflect their own experience and hence preclude any generalization.

Conclusions

Clearly a considerable amount of power has theoretically been devolved in both states and it appears that the Gram Sabha in Madhya Pradesh is stronger than its counterpart in Orissa. However, in Madhya Pradesh, people at the grass-roots level are over-burdened, not only with the number of committees, but also with the imposition of an increasing number of powers, functions and responsibilities, of which they are not fully cognisant. In reality, in both states, decision-making at the village level is still firmly with the *Sarpanch*, who in most instances represents the interests of the traditional power groups (landowners and upper castes). There has been an increase in people's participation in local elections and in their representation, however, it has had no apparent impact on the political decision-making at the village level.

The provisions for reservation and positive discrimination and the discretionary devolution of power to the community have not *ipso facto* led to representation and empowerment. This feature together with peoples' low levels of awareness of institutions means that there has been little or no empowerment. Thus, although some changes are taking place, the overall path of development is skewed to serve the interests of the traditionally dominant groups. It is, therefore, important at policy and project levels to identify drivers that could be used to empower communities if local government institutions are to act for the people. However, these drivers would differ in each district concerned. In Betul,

where independent leadership is emerging, these leaders could be involved in designing local development programmes. In predominantly agricultural districts, the rural elite are the main economic actors, that is, the main source of wage employment and hence there is a need to ensure that policy interventions do not have adverse economic impacts.

The new hierarchy of institutions created by legislation has tended to re-enforce the powers at district level, and (in theory at least) at village level. As such the block-level institutions have been marginalized to a degree. The real authority remains vested at district level through powers and responsibilities granted to bodies such as the DPC and DRDA. The new legislation has reinforced the power relations they were expected to change. Additionally, at the district level, it is government functionaries who have more power than the elected representatives with the District Collector still the real centre of control. Thus, the varying use of discretionary power has not made any significant difference in the way local communities participate in local governance in the two states. In neither state has representation and empowerment improved to any noteworthy extent. The power structure embodies top-down relations limiting scope for lower level initiatives for any substantial change in the way rural economy is managed. As the real power resides with the District Collector, his/her involvement will be crucial to any policy intervention at least initially, although in the longer term, there is a need for more real devolution of authority.

Local government institutions have had very little effect on rural non-farm livelihood opportunities. They have provided no supportive governance for the development of such activities as they do not consider it their role to promote or enhance livelihood opportunities. Promotion of livelihoods is considered the domain of the line departments. However, PRIs have proved better at executing small construction projects and delivering welfare

services, and it is important to build on these strengths. If local government institutions are to act as agents of local economic development, their capacities for understanding local economic issues and planning have to be strengthened. The CSS, with their emphasis on small-scale improvements and poverty alleviation, do not provide the impetus to local growth and the district-level development agencies lack the expertise or the vision to initiate any significant economic change at district level and below. It will be necessary to focus policy on district-level initiatives to improve co-ordination and the enabling environment for economic growth. There is scope to explore the possibility of private-public partnerships where the former would provide the expertise to identify emergent sectors and potential markets.

There are a large number of players at the village level, but only a limited number contribute to promoting non-farm activities. Co-operatives and banks appear to have made the highest input into developing non-farm activities. The RNFE's diversity combined with the multi-sector and geographically dispersed nature of the support that is required, provides in itself a strong rationale for developing flexible and wide-ranging institutional coalitions. As seen above, the large numbers of institutions that have already invested resources (human and financial) at the village level have yet to create linkages and synergies. Ideally the local government institutions could help to develop such linkages and coalitions to provide support for rural non-farm activities. However, there are two difficulties to achieving this: (i) the poor capability of local government institutions and the general lack of confidence in them; and (ii) different institutions have different agendas.

Realistically, user groups/committees will remain important partners in rural development,

while the PRIs in both Madhya Pradesh and Orissa attempt to understand the powers and functions devolved to them. This means that the low accountability to constituencies and continued domination of PRIs by traditional power groups will have to change before they are considered as partners by the donor agencies. However, in the longer term, to ensure the sustainability of these projects, PRIs will have to be involved.

According to Blair (2000) (discussed above), decentralized governance will lead to reduction in poverty only if there has been an increase in participation, representation, empowerment and enhanced benefits for all. Our findings show that participation in the electoral process has been quite impressive, with nearly 90% turnout. All disadvantaged groups are represented as required by law. However, the politics of co-option and ostracism of these representatives from decision-making means that in reality there has been little or no increase in representation. Hence, no empowerment and only a small percentage have benefited. This leads one to conclude that decentralized institutions so far have not had any significant impact on poverty reduction. The issue of growth and poverty reduction through decentralized government in India has been further complicated because elected members do not see themselves as economic actors.

In policy terms, it is important that the capacity of PRIs to participate in development projects be strengthened. This means a more focused programme of capacity building than has been implemented in the past by the state governments. This would need political commitment from the government and support from donors. The link between PRIs and project-based user committees needs to be both better understood and where appropriate, strengthened.

Implications for Policies to Promote the Rural Non-Farm Economy

Policy implications for the rural non-farm economy (RNFE) development centre upon two key issues: (i) a stronger emphasis on policies to diminish poverty; and (ii) a focus upon generation of rural growth through both supply and demand-side policy innovations. The requirements are for quite radical, sustained and long-term interventions that ultimately break with many of the policy preoccupations of the past. Given a long timeframe before likely impact, there is also a need for interim short-term policies that can alleviate poverty and/or provide safety nets to the poorest. The most immediate option is through food or cash for work programmes that are more effectively targeted both upon the poor, and upon productive infrastructure.

If poverty alleviation and growth are to be tackled effectively, there appear to be four broad policy areas that link and interact with each other, which can have positive impacts upon both the RNFE and agriculture:

- institutional development for more effective local governance for economic development and to mobilize producers and savings
- ongoing investment both to reduce supply bottlenecks and to promote demand
- development of an enabling environment for private enterprise
- constructive disengagement by government at all levels coupled with wider deregulation.

The first three of these policy conclusions arise from the research undertaken for this study, whilst the fourth is also informed by the work of others (notably Saxena, 2003), particularly with respect to the macro- (national and state-level) policy components. Each is considered in more detail below.

Institutional Development

Policies that effectively tackle poverty through promotion of the RNFE and agricultural sectors will need to incorporate significant areas of institutional development and innovation, particularly in terms of institutional process and institutional structures. Over the past decade, much effort has been expended in India on decentralization through the PRI programme, but its effectiveness to date, especially with respect to economic development, is highly questionable (Dasgupta *et al.* 2003). PRI structures were intended to empower rural populations including the poor and women and to provide mechanisms for local development, but in practice they have tended to reinforce local power elites and little economic activity has been generated. Real authority remains focused at district level through bodies such as the DPC and DRDA, and a pivotal role continues to be played by the District Collector, rather than through elected bodies and representatives. Neither representation nor empowerment (especially for the poor and women) has changed to any significant degree, and most elected representatives lack the will and capacity to implement initiatives that could support the RNFE or rural livelihoods more generally.

A number of policy options are available which could redress these institutional weaknesses. There is scope for policies which seek to upgrade the PRIs where possible, and to simplify structures where this can enhance their capabilities. There are also opportunities to improve the quality and direction of parallel government bodies and agencies. Finally policies can be pursued which engage a wider range of institutions working in collaboration with each other, including CBOs, NGOs, local financial institutions and the private sector.

Some Gram Panchayats have demonstrated a capacity for small-scale development of local social facilities and services. These capabilities could be developed further by policies which encourage a more systematic choice of village-level projects and which include, for example, infrastructure with more direct economic value for the community. This type of development can be combined with policies promoting more effective real decentralization of authority, and progressive simplification (if not elimination) of many of the committee structures that have recently been introduced at village level (Dasgupta and Marter, 2002). Village PRIs (e.g. the Gram Sabha and Palli Sabha), could also be rationalized such that where possible smaller units are avoided, since experience to date indicates that it is the larger PRIs that have been the most active, especially those able to tap revenue from market licensing (Kumar, 2003, personal communication).

Reform of village-level PRI bodies needs to be coupled with similar capacity building of the District Rural Development Authorities that select the activities funded in the district (Dasgupta *et al.* 2002). This component is needed for a wider promotion of change within local line departments, not only for upgrading of skills, but also to induce a crucial change in mindset towards real delegation of authority to elected PRI bodies. This also implies policies which seek to diminish the current concentration of power amongst District Collectors and a few local officials.

The types of expertise required amongst functionaries at the district level includes economic components such as the capacity to identify emergent sub-sectors, new markets and products. At all three levels of the PRIs themselves, capacity building of elected members is needed to improve their understanding of local economic and planning issues, linked to a much stronger emphasis on the importance of their role as facilitators of economic as well as welfare activities. Similar comments apply to PRI bodies and other local authorities in small urban centres where there is a particular need for more capacity to promote the local business environment (Wandschneider, 2003; Kleih *et al.*, 2003).

However, whilst PRI structures can be reformed and improved, it is questionable whether decentralization closely aligned to government institutions alone can provide sufficient genuine local autonomy. Further policies are, therefore, required which promote much more flexible approaches that embrace a range of institutions, are more inclusive, and which focus at least as much on economic functions as upon social objectives. This type of innovation is also needed because of the RNFE's diversity and the multi-sector and geographically dispersed nature of the support that is required. One option is for local government institutions to develop such linkages and coalitions (Dasgupta *et al.*, 2002), but flexibility is desirable depending upon the relative strengths of other local bodies and institutions.

Economic functions are likely to be better served by non-PRI bodies that include producers and other entrepreneurs. There is a need for policies which promote flexibility in choices of appropriate (existing) institutions, and for a long-term strategy that avoids overloading such bodies with multiple functions in the early stages. Finance, whilst important, is only one of a number of interlinked and complementary factors that include the organization of both input supply and marketing.

For finance itself, there is scope to move away from public sector provision via purely credit-based bodies and towards policies which promote local savings through a range of possible institutions, which may subsequently tap parallel funding to extend loan capacity. This approach is similar to that intended for the self-help groups, although the latter only represent one option (Adolph, 2003). Other CBOs, NGOs or producer and marketing bodies may be equally, if not more, appropriate. Input supply and marketing of outputs represent two key additional areas where local producer bodies and other institutions can play a role (Marr, 2003). By organizing bulk purchase of inputs and sales of outputs, such groups internalize costs and are in a much stronger position to negotiate with both suppliers and buyers. A strategy of progressively building up such activities from a relatively simple initial base is desirable, given current limitations in local skills and experience.

Much of the policy initiative and implementation required for institutional development is at state and district level, where flexibility to engage locally appropriate bodies can more easily be implemented. Government agency responsibilities are likely to become increasingly those of facilitation, including the encouragement of coalitions of institutions (e.g. NGOs, CBOs, the private sector, etc.) as a means of promoting commercial capability at the local level (Marter, 2003). To achieve such relatively radical innovations will require effective drivers to both initiate and sustain change: these may come from within administrations (e.g. progressive administrators), and/or be assisted from elsewhere (e.g. aid agencies and perhaps NGOs or even the private sector).

Productive Investment

Many policies which promote investment and the development of the RNFE are relatively long term with respect to achievement of impact. As noted earlier, there is thus a need for interim measures that can tackle poverty and/or provide safety nets to the poorest, notably through food or cash for work

programmes and upon productive infrastructure (Marter 2003). Examples include investment in rural and district-level roads, and also water infrastructure, with the use of labour intensive approaches as far as is feasible. There is also scope for ongoing programmes linked to maintenance, especially where these can operate in the agricultural off-season. More effective targeting systems to ensure that benefits reach the poor are an essential component, this being in part a function of more autonomy and representative bodies at local level (as described above under policies for institutional development). The need to improve targeting also reinforces the case for strengthening capacity at grass roots level in economic understanding and participatory planning.

There is also considerably wider scope for both public and private investment (e.g. through joint ventures) which can free up supply constraints providing a more viable environment for both agriculture and the RNFE (Kleih *et al.*, 2003). These initiatives can also stimulate demand, since local wage employment in infrastructure can have multiplier effects on local markets. Arguably the latter are at least as important as the former. Coupling investment with more local autonomy to decide the most appropriate strategies, for example, use of labour intensive methods, can further increase the scale of multipliers. This is especially important given the need to expand demand components in the context of low purchasing power associated with poverty. This comment applies in particular to states (e.g. Orissa) or districts (e.g. Bolangir and Betul) where there are high concentrations of scheduled tribes and scheduled castes – both groups being virtually synonymous with acute poverty.

Urban centres can play a pivotal role as local markets or access points to longer distance markets for the RNFE, and also as conduits for raw materials that may be needed from outside the locality (Wandschneider, 2003). However, study findings indicate that smaller centres in practice provide only limited facilities both for marketing and input supply. Equally they

generate relatively little employment for associated rural localities. The reasons for such limited impact are partly because the smallest centres simply lack much critical mass to stimulate enterprise and employment. However, a key aspect for all urban centres is the relative strength of agriculture in surrounding regions. In a number of cases in the survey areas, agriculture is weak and rural localities are characterized by chronic levels of poverty.

Thus whilst part of the answer for improving the level of urban enterprise may lie in policies promoting investment in improved infrastructure, including both transport and power supply, there are also wider policy needs. Policies are required which strengthen local agricultural performance and which stimulate local (rural) demand (cash for work being one example). There may also be a case for more selective investment initially in larger centres which have more existing linkages with the RNFE, and hence greater potential for immediate impact.

Further policies to promote investment could be available through selective facilitation of joint ventures through major domestic (and possibly international) corporations, which may be appropriate given their capacity to invest, not only in physical assets, but also via their managerial capability, and access to markets. Such investments can act as a stimulus to wider economic activity in both the RNFE and agricultural sectors. Policies are required which encourage major companies both to invest and also to take on additional productive roles, for example, through inputs to training to raise local skill levels and also commercial capabilities, especially in marketing.

The Enabling Environment

The enabling environment for enterprise is a key area impacting on the development of the RNFE, and one where a number of policy initiatives are desirable, both for rural locations and associated urban centres. Such initiatives will involve the reshaping of public sector roles towards

facilitation rather than intervention, and a corresponding change in mindsets of administrators coupled with capacity building (as noted under institutional development above). The required change of mindset at district level to create a more business conducive environment can be linked to increased local fiscal capacity to raise revenue for infrastructure development, notably district roads, but also market infrastructure including possibly storage capacity. Additional skills are needed in management, finance and banking (Kleih *et al.*, 2003).

At district level, there is scope for policies which can support and stimulate business development (Saith, 2001). In addition to more Business Development Services (BDS), competent support units for rural enterprise development are required at local government level. In particular the small- and medium-scale private sector needs to be encouraged to become better organized, for example, in the business forum, and to participate in district planning committees (Kleih *et al.*, 2003).

A flexible approach is desirable that can adapt to local institutional capacity, work with existing agencies where possible to strengthen the BDS and raise capabilities, for example, in analysis of market opportunities and associated alternatives for local enterprise at sub-sector level. Besides an enabling infrastructure, this involves improved planning at block level, and better linkages with research institutions and the industrial manufacturing sector (e.g. pharmaceutical industries requiring medicinal plants as input). This may be particularly important for some 'traditional' RNFE sectors where demand is static at best and where it may be more realistic to encourage diversification, rather than to continue to support manufacturing of products where demand is increasingly constrained (Kleih *et al.*, 2003). Such support can also assist in raising local business capability, for example, to identify scope for the introduction of new technologies, input and design improvements, together with manufacturing capacity at the local level. These strategies relate both to the needs of

rural areas and also to associated small urban centres. For small towns, a key requirement is the development of local expertise in financial management, business planning and marketing (Wandschneider, 2003).

Policy measures are also needed to address weaknesses in markets – both for inputs and outputs of the RNFE. Some raw material supply markets can be improved through the strengthening of local governance institutions for improved management of natural resources, whilst there is a more general need for the encouragement of more efficient raw material supply markets. In some cases this approach requires disengagement by government bodies (see below). Improved market access, particularly for small-scale RNFE producers, can be assisted through enhanced access to information on market prices and marketing opportunities (e.g. more transparency through policies promoting information kiosks at block level), creation of storage facilities at the Panchayat level/cluster of Panchayats, and reforms of local *mandis* (Kleih *et al.*, 2003).

These types of activities require policies and approaches that go beyond private/public partnerships and include NGOs, the banking sector, training agencies, not-for-profit companies, co-operatives and self-help groups (i.e. the encouragement of coalitions noted under institutional development above). A key component is the better representation of rural SMEs to ensure that their needs are included in the reshaping of business environments. One of the more difficult aspects of policy will be to identify the most appropriate institutional base to further improvements in the enabling environment. In some locations, progressive elements within the DRDAs may be appropriate, but elsewhere alternatives will be needed.

Below district level, there are opportunities to rationalize and improve the capabilities of local people and institutions, especially with respect to economic functions, but such policies will necessarily be fairly long term. A range of

capacity building and training components will be needed. Confidence raising and empowerment will be needed for the poor, especially women, and choices need to be made over the degree to which existing caste and gender barriers can be modified or simply accommodated (Marter, 2003). The latter comment applies to both rural and small urban areas, since caste and gender constraints in such towns appear virtually the same as in surrounding rural areas (Wandschneider, 2003). Other needs can be met partly through training in basic organizational skills and also vocational training, especially for younger entrepreneurs, for the necessary technical skills, development of basic business enterprise, and generation of capacity to assess market opportunities.

All these activities will need to overcome the bias towards formal education that is widely held, in comparison to vocational training. A mechanism that can help to do this is to link vocational training directly to private sector practical experience (via attachments) and to realistic business and marketing opportunities coupled with input credit options if feasible. The problem is that in the short and possibly medium term, local business environments are likely to remain weak. However, the recent trend towards creation of Rural Development Cells by large corporations (e.g. Hindalco in Sonbhadra, Uttar Pradesh), might represent an alternative (Kleih *et al.*, 2003). Given their resources, such corporations are able to invest in skill building and promotion of the RNFE in rural areas through intensive operational support processes. The first policy need, therefore, is for analysis of the performance of the Rural Development Cells, particularly the degree to which operational support activities are converted into free standing enterprise.

Many of these suggestions raise questions as to the source of training resources and trainers themselves. A presumption by some is that public sector provision (as in the past) is the answer. However, the range of required skills, including many commercial components, suggests that

more diverse approaches may be needed, including the private sector (Kleih *et al.*, 2003). Findings for small urban centres also show that a strong preference exists amongst many local entrepreneurs for private sector provision of training and advice on technology and business development (Wandschneider, 2003). There may in fact be scope for policies which promote not just public/private partnerships, but also coalition approaches in training, and in the development of local production and marketing agencies, that include NGOs, CBOs and hybrid bodies such as not-for-profit companies, etc.

Disengagement by the Public Sector

Findings of research presented in this study provide numerous examples which point to the need for more flexible approaches on the part of government bodies, including real delegation of authority to local institutions (Dasgupta *et al.*, 2002), and a move towards facilitation rather than direct participation by government. In economic terms, direct intervention by government agencies has often been unhelpful, for example, with respect to input supply (such as loan programmes directed towards inappropriate investments) and marketing (such as continued promotion of sales from traditional industries which face declining consumer demand) (Kleih *et al.*, 2003; Marter 2003). There has also been a failure to meet the business development needs of both rural and small urban areas (Kleih *et al.*, 2003; Wandschneider, 2003). These findings also point to the need for engagement of a wider range of institutions to support development of the RNFE, including much wider involvement of the private sector.

These essentially micro-level conclusions are echoed by other researchers who have assessed the macro-policy environment. To date, national

and state-level policies for poverty reduction and economic growth in India have generally entailed substantial levels of government intervention, despite moves towards liberalization in the 1990s. The focus has been essentially on supply-side components (Saxena, 2003), especially credit programmes, coupled with decentralization (via PRIs). Subsidized programmes and government direction rather than reliance on the operation of markets are still commonplace. Whilst many such policies have been pursued for 40 years or more, their impact on poverty has been limited, and growth in both the RNFE and agriculture has been constrained.

Liberalization policies and programmes, therefore, need to be revived and extended, especially in areas that affect small- and medium-scale enterprise, which are often subject to the greatest restrictions. There is substantial scope to progressively rationalize the regulatory environment to remove restrictions and transaction costs where these arise in both agricultural and RNFE production, and especially in marketing systems (Saxena, 2003). Selective privatization as a long-term objective also needs to be rejuvenated, especially where this can improve key areas of infrastructure, the most obvious being electrical power generation and distribution. In the short- and medium-term, the main options for electric power may lie in privatizing elements of distribution, for example, the purchase of power units by consumer groups who subsequently take responsibility for distribution, as has happened in some parts of Orissa (Andrew Barnett, 2003, personal communication). In other sectors, there is also a need for a reduction in subsidies, especially those that distort (and often constrain) more rational patterns of agricultural production. These moves will need to be prompted at national level, but will also require real commitment from state governments (Saxena, 2003).

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Details of the Study Area

Appendix

State	District	Block	Panchayat
Madhya Pradesh	Narsimhapur	Gotegaon	Manegaon
		Chichli	Jotheshwar
	Betul	Betul	Batesera
		Bhimpur	Thalwada
Orissa	Nayagarh	Devgaon	Janthapur
		Khanapada	Adarsh Dhanora
		Belpara	Palaspani
	Bolangir	Odegaon	
		Daspalla	
		Gania	
		Titlagarh	

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