

The rural economy is not just about farming

It is no secret that millions of Indians are moving to cities in search of better lives. The facts about the rapid transformation of the rural economy in recent years are less well known. These facts are important given that India has to create around 10 million jobs every year to stave off social unrest.

A new paper written for the NITI Aayog by Ramesh Chand, S. K. Srivastava and Jaspal Singh provides fascinating insights into the structural transformation of the rural economy. More than half of Indian industrial production comes from the rural areas. Rural construction also accounts for nearly half of the total building activity in the country. The value of rural services is about a quarter of the total services output. Agriculture has accounted for less than half of total rural output since the turn of the century.

Rural industrialization is clearly the big story. Production by rural factories was only a quarter of the total industrial production in the country in 1971. That share doubled by 2012. The puzzling fact is that the share of rural industrial employment in total industrial employment has been around the same over those four decades. The three economists suggest that rural industries have been more intensive users of capital than their urban counterparts, though there is no detailed examination of this paradox in their paper. It is also not clear whether the numbers of rural output are skewed because data from the census towns have been included.

The higher capital intensity of rural industries is puzzling because one would have expected the opposite, given the fact that rural wages are lower and rural industries are likely to be more credit constrained than urban industries. The lack of adequate job creation by rural industries is balanced by the rising share of rural construction work in employment statistics. The rural housing boom in the first decade of this century absorbed millions of workers.

Chand, Srivastava and Singh pose what could be the central challenge of Indian public policy in the coming decades. Rural employment has shrunk after 2005 while the urban areas have not been able to absorb the millions who are leaving the farm. The Narendra Modi government has to figure out whether it wants to deal with the problem of rural joblessness indirectly through promoting urban growth or directly through the creation of jobs in villages. This NITI Aayog paper suggests the latter course while the action plan released earlier this year argues in favour of the successful Asian strategy of creating quality jobs through the expansion labour-intensive modern manufacturing.

The development experience of most successful countries has involved a shift of labour from traditional sectors with low productivity to modern sectors with high productivity. Countries such as India that have not yet made the transition inevitably have dual economies—where the traditional sector coexists with the modern sector. Mainstream growth models deal with a single sector with a single production function, and hence have their limitations in a country such as India where multiple economies exist in proximity to each other. We saw this dualism during demonetization, when the formal and informal sectors did not deal with the policy shock in the same way.

The question then is whether India should bank on the Asian development model of helping people move to high-productivity activities or try to raise productivity levels in the traditional sectors? Some of the ongoing debates on the need to bring informal enterprises into the formal economy need to be framed against the backdrop of this big policy choice.

This column had earlier cited a paper by economists Xinshen Diao, Margaret McMillan and Dani Rodrik, in which they empirically examined the drivers of economic transformation across the world. The three economists decomposed growth into two categories—labour productivity

changes within a sector on the one hand and the change in labour productivity as people move from the traditional to modern sectors on the other hand. They argued that the Indian experience comes closer to the latter course, Asian rather than Latin American.

As B.R. Ambedkar wrote nearly 100 years ago: “In short, strange as it may seem, industrialisation of India is the soundest remedy for the agricultural problems of India. The cumulative effects of industrialisation, namely a lessening pressure (of surplus labour) and an increasing amount of capital and capital goods will forcibly create the economic necessity of enlarging the holding. Not only this, but industrialisation, by destroying the premium on land, will give rise to few occasions for its sub-division and fragmentation. Industrialisation is a natural and powerful remedy...”

And then the 1936 political manifesto of his Independent Labour Party noted: “The party believes that the fragmentation of holdings and the consequent poverty of the agriculturists are mainly due to the pressure of population on the land, and unless the pressure is relieved by draining off the excess population subsisting on land, fragmentation will continue, and the condition of the agriculturists will remain as poverty-stricken as it is today. In the opinion of the party, the principal means of helping the agriculturists and making agriculture more productive consists in the industrialisation of the province.”

The recent wave of rural industrialization would definitely have interested the great man.

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