The Importance of Agricultural Growth to SME Development and Rural Employment in Egypt

Special Study No. 5

USAID Contract #: 263-0219-C-00-7003-00

Executive Summary

July 2002

Prepared for
Government of Egypt, Ministry of Agriculture and Land Reclamation

USAID/Egypt
Office of Economic Growth, Competitiveness and Agricultural Development Division

Prepared by
Sarah Gavian,
Gary Ender,
from Abt Associates

Tamer El-Meehy,
Lamia Bulbul,
from Environmental Quality International

Cambridge, MA
Lexington, MA
Hadley, MA
Bethesda, MD
Washington, DC
Chicago, IL
Cairo, Egypt
Johannesburg, South Africa
EXECUTIVE SUMMARY

Agricultural growth can be a major driver of poverty reduction in developing countries. Agriculture tends to be a large sector, the income from which is primarily spent on domestically produced goods and services. To the extent that those good and services are produced using a high degree of labor, agricultural growth creates many jobs. Usually these jobs are created in nearby small enterprises that often employ the poorer, less educated portions of the society. Thus improving agricultural incomes not only improves the welfare of agricultural households and increases the food supply, but also has the very important impact of stimulating pro-poor, non-farm employment in rural areas.

Of course, other kinds of growth also create jobs. The issue is, how many jobs, for whom, and where? The link between growth and job creation thus depends on what types of goods are demanded, who produces them, using what resources, and facing what constraints? To address these issues, this report uses survey data from three governorates of Egypt (Assiut, Beheira, and Sharqeya) to test hypotheses related to 1) the importance of agricultural incomes in generating demand for non-agricultural goods and services in rural areas, 2) the tight links between the small businesses that make up the non-agricultural sector in rural areas and the surrounding community from which they draw their demand, labor force and input supply, and 3) the responsiveness of the small enterprises to increased demand, particularly in terms of job creation. Based on three different surveys of more than 1,200 small and micro enterprises (SMEs) and 600 households, the results provide estimates of total employment, household incomes and household expenditures for each of the sectors in rural areas of Upper and Lower Egypt. They also provide profiles of the different kinds of SMEs found in rural Egypt.

Rural Employment, Incomes and Spending

The household survey, carried out in February 2002, consisted of a sample of 600 households in rural (440 households) and urban (160 households) areas of Upper and Lower Egypt. Households were randomly selected from a complete listing of all residential units. Survey questions focused on how households earned their income and where they spent it. Households were asked to identify their sector of employment and expenditures in terms of agriculture, private non-agriculture (small versus medium and large enterprises) and government.

Agriculture is a large but slow-growing portion of the Egyptian economy. According to Adams, who uses IFPRI data from the 1997 Egypt Integrated Household Survey, agriculture (crop and livestock production) accounts for 32 percent of all income nationally, with the poor receiving as much as 41 percent of their income from agricultural activities. According to CAPMAS data from the Labor Force Sample Survey of 1998, the agricultural sector accounts for 29 percent of all employees nationally. In rural areas, as many as 48 percent of all employees work in the agricultural sector, whereas that share is only 5 percent in urban areas. Using CAPMAS national accounts data, agricultural value-added constituted 17 percent of gross domestic product in 1998/99.

The survey results suggest that the agricultural sector provides a modest amount of income (23 percent) to rural households. However, those households, in turn, do buy a very large proportion of their goods and services from SMEs, indeed most of them from rural SMEs. Taking income
and expenditures together, 19 percent of all demand generated in rural areas is represented by the link between agricultural incomes and rural SMEs. This is modestly behind the 24 percent share from the government-to-rural SME link and on a par with the 19-percent share from the SME-to-rural SME link. Thus the hypothesis that rural households rely on agricultural incomes and spend on small local businesses was supported, but the links were somewhat weaker than expected. A related hypothesis that urban households are less dependent on agriculture for their incomes and less likely to spend in local small businesses was strongly supported.

**Defining, Identifying and Profiling SMEs**

As the private non-agricultural sector in rural areas comprises primarily small (5-14 workers) and micro enterprises (1 to 4 workers), a second set of surveys was designed to determine their characteristics and potential for job creation. In order to capture all SMEs in operation, a distinction was made between established small and micro enterprises (E-SMEs) and home-based enterprises (HBEs), where the latter lack fixed independent premises. Because HBEs are fairly invisible (being located within homes and seldom registered with government), there were separate sampling strategies and questionnaires for the two different kinds of SMEs. The fieldwork for the established SME survey was carried out from March through May 2001 and targeted enterprises using official lists. The HBE survey was carried out in February 2002 and targeted enterprises identified within the households selected for the household survey. In all cases the sampling was random, and the surveys were carried out in the same locations as the household survey.

The effort to identify and sample HBEs uncovered a second universe of small and micro enterprises sometimes missed by other studies and every bit as common as their established counterparts in both rural and urban areas. In many ways, these HBEs have a different profile from their established counterparts. While SMEs as a class tend to be very small, rural HBEs are even smaller than E-SMEs (1.2 versus 2.0 workers). They are likely to be operated by one person (owner/worker), and twice as likely to be female-headed as their E-SME counterparts. Most sell their products from home, followed by the marketplace, and street vending. Their client base is overwhelming local, although more so for rural HBEs than urban ones. In rural areas (where there are agricultural activities), 54 percent of the respondents said that farmers make up most or all of HBE clients, as compared with the much greater importance (80 percent) of farmers for rural E-SMEs. Rural HBEs are more likely to use enterprise outputs for family consumption than their urban counterparts.

The prototypical E-SME is likely to be engaged in trading and employing about two regular workers: one a relative around 23 years old with an intermediate degree, and the other, around 45 and at best semi-literate. Rural E-SMEs are very dependent on their village for their markets (91% local versus 8% from a city or metropolitan area), whereas urban E-SMEs are more dependent on their city, although to a lesser extent (63% local). Although farmers are only a minor slice of the urban clientele, they are a very major part of the client base for rural E-SMEs.

SMEs also differ by sector of economic activity. For example, trade is the largest sector in terms of the number of enterprises. One explanation is the relatively low capitalization required, hence the ease of market entry. On the other hand, SMEs engaged in services are the largest in terms of both labor and capital.
SMEs exhibit a high degree of self-containment in the local economy in terms of customers, input and labor. The findings therefore support the second hypothesis that SMEs constitute a large sector that is highly dependent on the local economy for their demand, labor and other inputs. The implication is that changes in demand for SME products will be felt first and foremost in the local community. Thus it is possible for an increase in agricultural incomes to have a substantial impact on demand for local SME products and for the SMEs, in response, to demand more labor and other inputs from the local economy.

Growth Patterns and Dynamics

Having established that local communities are the major source of demand for the large SME sector in Egypt and that this relationship is even stronger in rural areas than in urban ones and that agricultural incomes make up a substantial portion (although not the majority) of that local demand for SME output in rural but not urban areas, the focus turns to how SMEs respond to an increase in demand.

Demand was hypothesized to be the major constraint to SME expansion, and SMEs were hypothesized to be ready to respond to an increase in demand. SMEs were also presumed to be labor-intensive, and thus respond to increased demand by hiring local labor. Rural SMEs were hypothesized to be more employment-intensive (i.e., use a greater proportion of labor to capital) than urban ones and thus more likely to add jobs when demand increases.

The results suggest that these effects may not be as strong as predicted, at least in the short to medium run. While the majority of both E-SME and HBE owners report the shortage of demand to be their most binding constraint, SMEs are not that ready to respond to an increase in demand by adding workers. Most SMEs have significant excess labor capacity and almost none employ seasonal labor. Most SME owners say they respond to demand increases by working harder and extending hours. Only 8% of rural SMEs said they would add workers versus 23 percent of urban SMEs. Most SME owners say they respond to demand increases by working harder and extending hours. Only 8% of rural SMEs said they would add workers versus 23 percent of urban SMEs. The majority of E-SMEs (the only group for which the data were collected) had no change in employment throughout their business lives. However, for the quarter to third of E-SMEs that did add workers, the addition represented a near doubling of their labor force. Thus there is some evidence that SMEs can expand, given sufficient demand, and that the urban SMEs are more likely to expand than the rural ones.

The link between job creation and labor intensity is complex. On balance, rural E-SMEs are far more labor-intensive than urban ones. However, rural HBEs are actually less labor-intensive than their urban counterparts. Furthermore, rural E-SMEs, despite their being more labor-intensive, are less likely to add labor (or capital) over their lifetime than urban E-SMEs. Likewise, the SME service sector had the largest workforce expansion, while paradoxically being the sector with the lowest labor intensity. It also is the most capitalized (in terms of both initial and total capital), the largest in size (in terms of the average number of workers per enterprise), and the least likely to suffer from underemployment and demand constraints. One implication is that to the extent that SME jobs are created through enterprise expansion, they are more likely to be created in urban areas. The majority of SME-generated jobs are mainly generated through start-ups, the study of which was beyond the scope of this research. Nevertheless, lengthening hours and working harder will translate into greater incomes, and eventually, if demand is maintained, to more positions. In either case, incomes increase.
Conclusions

SMEs are traditionally thought of as well poised to respond to increased demand by creating jobs. Their base employment is very large, they are highly labor-intensive, and they depend on their localities for labor and other inputs. Furthermore, they have low capital requirements and offer some opportunities for female employment and entrepreneurship. However, the potential for rural SMEs to generate employment through expansion must be qualified.

First, SMEs are not a homogeneous sector. Second, high labor intensity is not synonymous with the ability to generate employment through expansion. To the contrary, the group of SMEs that had the highest ability to generate employment was the least labor-intensive, and had the highest average annual capital growth rate. Third, again, when it comes to the ability to generate labor by expansion, urban enterprises fared better than rural ones. Fourth, the services sector, which had the highest ability to generate employment (and also the highest average annual growth rate in capital), was the least likely to suffer from demand constraints.

This, if anything, points to the importance of demand and economic growth for job creation. Continuing to provide supply side solutions to SME problems—though admittedly needed—without expanding the market for their products and services is highly unlikely to generate employment through expansion. Suffering from high underemployment rates—primarily due to the lack of sufficient demand to keep them fully employed—these enterprises will not generate additional jobs, except after their capacity has been fully utilized. In the meantime, however, increased demand will cause SME owners to work harder and earn more income. Extending hours either for the owners or workers should not only increase their income, but if widespread, should push up wages in the rural economy. Furthermore, while the study did not monitor job creation by start-ups, the results indicated that about one-third of all SMEs did expand their labor force, and a roughly similar proportion invested additional capital. Thus the study results suggest that SMEs are indeed a potential motor for job creation.

The issue then remains: how to prime that motor? What is needed to stimulate demand for SME goods and services in rural areas where poverty is greatest? The results indicate that the size of the agricultural sector, even in rural areas, may be fairly small relative to the non-agricultural (i.e., SME) and government sectors. But neither of these latter sources of income is robust. Where does the SME income come from in the first place? As long as there is something outside the SME sector growing, then the SME-to-SME link gets activated. That growth must come either from government, large businesses or agriculture. As Egypt continues macroeconomic reforms, government employment should diminish sharply, eroding its direct and indirect impact on demand for SME products. The private sector role in the economy must expand. The role of the medium and large enterprises in generating employment will be fairly minor because at present, such businesses are only a small piece of the economy. Thus the growth of agricultural incomes and demand will be critical to filling the void and creating new jobs.