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Does Non-Farm Income Improve The Poverty and Income Inequality Among Agricultural Household In Rural Kedah?

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Abstract

This paper used a primary data collected through a surveys among farmers in rural Kedah to examine the effect of non farm income on poverty and income inequality. This paper employed two method, for the first objective which is to examine the impact of non farm income to poverty, we used poverty decomposition techniques- Foster, Greer and Thorbecke (FGT) as has been done by Adams (2004). For the second objective, which is to examine the impact of non farm income to income inequality, we used Gini decomposition techniques. Our result indicate that non farm income can improve the level of poverty or non farm income sources contributed towards poverty reduction among agricultural household. All of the poverty measures show that the inclusion of non-farm income into the agricultural household income reduce the level, depth and severity of poverty. But on the other hand, non farm income increased income inequality among agricultural household in Kedah. As expected agricultural income is the main source of income for rural people in the study area. The policy implication of this study is to encourage non-farm income activities among agricultural households as this would raise their income and hence, reduce poverty among them. However, it should be focused on value-added activities, especially on the lower income group.

Keywords: non-farm income, poverty, inequality, Malaysia

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1. Introduction

Non-farm income is important for poverty reduction (de Janvry and Sadoulet, 2001) and for improving household welfare (Reardon et al., 1992; Reardon et al., 1998; Barrett et al., 2000; Canagarajah et al., 2001). Haggblade et al. (2005), for instance, report that non-farm income contributed 30 - 45 percent of rural household income across the developing world. Based on a review of a number of studies using rural household surveys conducted between the mid 1970s and the late 1990s, Reardon et al. (1998) finds that non-farm income as a share of total household income averaged 42 percent for Africa, 32 percent for Asia and 40 percent for Latin America. In Ghana, non-farm employment is an equally important source of income for rural households. On the other hand the empirical evidence on the effect of non-farm income on rural income inequality is mixed. Canagarajah et al. (2001) observes that this result may be due to the heterogeneity of the non-farm sector.

Malaysia has made remarkable progress in reducing poverty since the introduction of a New Economic Policy 1970 with the headcount poverty rate declining from 37.7 percent in 1976 to 3.6 percent in 2007. But in terms of income distribution as shown by the Gini coefficient found that in almost 40 years, the improvements shown in the income distribution is very small. The Gini coefficient decreased slightly about 0.072 from 0.513 in 2007 to 0.441 in 2007. The question now, is this imbalance in income distribution is related to the non-farm activities. Specifically in this paper, we are trying to find the percentage of farmer having the source of non farm income. And to what extent the income received from non farm activities can increase farmer's income and thus reduce poverty and to what extent the non farm income effect the income inequality.

2. Literature review

The empirical evidence on the effect of non-farm income on rural income inequality shows mixed results. Studies such as Reardon and Taylor (1996), Reardon et al. (1998), Adams (2001), Elbers and Lanjouw (2001) and Woldehanna (2002) find that non-farm income increases inequality because non-farm income is unequally distributed in favor of the rich. Lanjouw (2000), found in the state of Ecuador, non-farm sector contributed 40% of rural incomes. Nearly 40% of men and 50% of the women involved in this activity and also income from non-farm employment is associated positively with the level of education and infrastructure. De Janvry (1981), wages from a part time job in rural areas often complement the inadequacy of agricultural production to ensure the needs of household consumption will continue to be enjoyed. De Janvry et al. (2005), studies in China, involving 7041 households with agricultural and non agricultural income showed, 72% of rural households have non-farm income. Non-farm income is not only able to absorb surplus labor in rural areas, but more importantly what it can improve is the quality of life in rural areas. It can be concluded that non-farm income can be considered as a potential successor to the agricultural income. On the other hand, Adams (1994), Lanjouw (1998) and Zhu and Luo (2006) find that non-farm income decreases rural income inequality. Reardon et al. (2000) observes that the assertion that non-farm income reduces income inequality is premised on three empirical assumptions: 1) that non-farm income is large enough to influence rural income distribution, 2) that non-farm income is unequally distributed, and 3) that this unequally distributed non-farm income favors the poor.

Non-farm income also plays an important role and exhibits an increasing share in agricultural household income (De Janvry et al., 2005; FAO, 1988). Thus, the non-farm (or off-farm) employment has been generally recognised to have the potential in raising agricultural household income, and therefore reducing rural poverty (FAO, 1998; Arif, Nazli and Haq, 2000; Lanjouw and Murgai, 2008; Foster and Rosenzweig, 2004). Non-farm income gradually became an importance source of income for rural households, and served as an engine of growth for rural areas. Adams (2001) on his study at Egypt and Jordan, find that non-farm income has a

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