RURAL CAPITAL FORMATION AND CREDIT IN WEST JAVA

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ENGLISH SUMMARY

I. Rural business elites in West-Java

Field work results of this study confirm observations made from the 1920s onward on the existence of a long-term trend of asset concentration in rural West Java, Early observers mentioned an increasing concentration in landholding patterns (summarized in van Dijk 1981. see also van Dam I961 Svensson 1983). Which more recent studies confirm (HanJjono 1990d, Horikoshi 1976, Siregar 1989, White el al. 1989). Evidence on non-agrarian sectors (trade, transport, industry) is less substantial (see references above), but points to a similar trend. The case studies reported here show how welt set the "rural elites" were to reap the benefits of the strong economic growth in West-Java during the past 25 years. Our estimate is that at present the bulk of rural assets (Land, capital, fixed assets is controlled by approximately 5 to 10^% of the population living in the West-Javanese countryside,

A main conclusion of the Capital Formation study is that the rural elites, in their investment strategies, do not realize the non-farm employment generating potential of assets under their control.

The primary constraint on investments in the non-farm sector is limited investment opportunities ("real' as well as "perceived") rather than capital scarcity. The above holds true both for agrarian elites and for industrial elites. Limited information - on market demand, technical and managerial know how, banking procedures - explains best why agrarian elites, even when they are ideally positioned in terms of market access, demand and the availability of funds, do not make the jump from agriculture to industry; why rural industrial elites cling to crafts industries, simple food processing operations and the like; and why more complex and non-agriculture based industries in the countryside are invariably controlled by urban industrialists. Below we consider this matter in detail.

The banking deregulation has caused aggressive competition among hanks for clients. The impact is clearly visible in the countryside, where business elites report they are

often visited by hank agents offering loans and promoting savings schemes. The thesis of limited investment opportunities is underlined by the relative lack of response among the elites lo the recent rural banking explosion.

II. Rural industrial elites

The scope of rural small and medium-size industries in West-Java controlled by rural business elites is very limited in terms of technology and product range. In most investments the share of fixed capita I is insignificant in comparison to that of working capital. And most industries have strong linkages with agriculture; rural industry is in most cases a more or less advanced form of "agro-processing", as in the dominant handicrafts and foods processing sectors, in leather tanning, etc. The combination of simple technology and local resources makes rural industry linkage poor. Multiplier effects of rural industries are of a very limited nature ret. ILO Moreover this narrow base leads to chronic overproduction.

Limited information in general and a lack of technical know-how in particular seem to be the main obstacles in the path of diversification. For one. Educational levels among die business elites are very low or unrelated to enterprise. The importance of knowledge in the shape of engineering, marketing and business administration degrees, or merely in information picked up during a longer stay in an urban center, should not be underestimated; in several case studies of "advanced" rural industries these factor; are mentioned as a key feature of rural economic diversification (Byrd et al. 1990 on China, Rutten 1986 and Upadhya 1988 on India).

A. Position of producers: demand and supply

The limited product range of rural industries and simple technology tend to lead to overproduction. Overproduction is a very common phenomenon in many sectors of the rural industry. Examples of mass imitative competition abound, where a certain commodity market is swamped by new producers entering en masse after the example of one innovating entrepreneur has proven successful. In the poultry industry this trend toward overproduction was even, albeit unwillingly, reinforced by government intervention (Hardjono 1990b).

Industries escaping from the overproduction trap include:

1. Rural industries with high entry barriers, usually a combination of high initial investments, more complicated production presses requiring technical knowhow, and difficult market access, or sometimes entry barriers in the form of regulations.
2. Rural growth industries where demand outstrips supply even as production continues to expand. Cues in this category concern rural industries that have linked up to foreign markets, like the rattan industry and other crafts industries. Another case is the garments sector, which has profited from less

intense competition inthe domestic market from large enterprises many of which have turned to export. Field research focused on this category of export-oriented growthindustries, which have gamed much in importance during the past years.

B. Industrial elite investment strategies

In cases where producers face a buyers' market because of overproduction, the business elites either hang on for lack of an alternative, or, in some cases they succeed in maintaining profitability levels by securing personal market channels (Van Velzen 1990).

From one research location to another, business elites display a differing rate of inter-sectoral mobility. No clear cause for these varying patterns can be identified. An explanation in terms of market forces, where entrepreneurs move assets from one sector to another by comparing profitability, is unsatisfactory.

In export-oriented growth industries, exemplified by the rattan (Tegalwangi) and pandanus {Rajapolah> handicrafts industries, investment patterns are as follows: In the pandanus study, the business elites do not become producers but put out production to small dependent craft enterprises. They manage to control the industry because they monopolise market access. In the rattan case, business elites are themselves large producers, and sub-contract surplus orders to a second tier of smaller enterprises, who in turn pass surplus orders on to a third layer of household industries. Small and medium-size producers invest surpluses in additional working capital, the large producers with easy access to bank credit lend to invest in fixed assets (land, premises). In the pandanus case the traditional crafts industry structure is left completely unchanged: production techniques and the organization of production are left intact and linked up to the distant urban and foreign "luxury" markets. In the rattan case production techniques undergo small changes, while the industry displays a pyramidal size structure. Even the largest production units are no factories in die real sense, since variable capital still prevails over fined capital. We conclude that business elite investment strategies lend to be conservative with regard to the organization of production. The business elites, though possessing the means, as much as possible refrain from carrying through any radical reorganization of production.

C Export-Led growth markets: market access and bargaining power

Two relationships must be distinguished:

1. Between large and small producers operating in an industry, and
2. Between producers and input suppliers and buyers of their outputs.

In export-led growth markets for rural industry produce, the limited number of producers or producer/traders with access to distant markets are producer/traders with access to distant markets are The centerpin of the industry: market access is a crucial asset. 1 he

rattan and pandanus cases (Tegalwangi and Rajapolah) show that a shift from domestic low-price mass markets to high-income domestic (urban) and export markets, while offering room for considerable expansion of production, entails a restricted access of producers to their now distant markets.

This shift mikes the hulk of producers in the industry dependent on the small number of firms in possession of scarce market outlets. Hence, while production in the industry as a whole increases, unequal market access causes a disproportionate part of the benefits of this growth lo accrue to a small number of producers/traders occupying these key positions.

This dependency is also reflected in the unprotected position of the smaller entrepreneurs and workers employed in the sub-contracted firms. Risks associated with demand fluctuations are largely transferred to the sub-contracted businesses. Furthermore piece-rate contracts tend to depress wages, where the lower one moves down the sub-contracting chain, the more these negative are felt.

D. Export-oriented growth industries and the labor market

The Tegalwangi case indicates that high labor mobility forecloses any possibility of a small industry growth pole becoming a rural high wage enclave. The continuous influx, of new workers maintains the present weak bargaining position at local labor versus entrepreneurs even while the industry expands rapidly.

III. Agrarian elites

A. Elite investment strategies

The most important investment trend emerging from three village-level studies of large landowner investment patterns is that agricultural surpluses are mainly plow back into agriculture or invested in related activities, predominantly downstream of agricultural production (in agro-processing or agro-trade).

Reinvestments in agriculture show the following patterns:

1. In the two irrigated village studies, two decades after the onset of the Green Revolution, sectors connected with the production, processing and trade of high-yielding rice varieties have absorbed capital up to and partly beyond the point of saturation. In both cases capital has also been redirected from the rice sector U> ventures in high-value agricultural commodities, in one case shrimps and in the other case vegetables. Various other studies undertaken in West-Java come up with similar findings (e.g. Kawagoe et al. 1990), and point to the importance of the demand pull exerted by large urban markets (foremost the capital Jakarta). Overall, if we include trade, processing and transport activities the agricultural sector remains the main recipient of local investment flows.

2. Investment flows in the case of the "poor" rain-fed sawah village case have; not predominantly been directed to agriculture, this sector still offering many opportunities for productivity-raising investments Only recently and hesitantly has private capital been directed to primary sector investments of an infrastructure (pump-sets).
3. In all three cases investment into upstream markets in the rice sector (equipment, seeds, fertilizer, pesticides) lag far behind capital flows to downstream markets {rice milling, trade and transport). Main barriers \u investments in upstream markets by rural entrepreneurs are the high degree of state intervention in the case of some products, like fertilizer and seeds. And the large scale of production that most inputs require, with large upstream firms in control of distribution channels. By contrast rice procuring and trade are very much deconcentrated, offering a natural downstream investment opportunity for large farmers.

A second main finding is that non-agricultural (off-farm) investments arc primarily directed to the trade and transport sectors. In the irrigated villages aggregated incomes of the elite samples show that agricultural (farm) and non-agricultural incomes (including agricultural trade, transport and processing) art balanced. In the rain-fed village the proportion of agricultural against non-agricultural incomes is roughly 2:3, Hence in all cases off-farm income in the broad sense of the word is an important component of income.

In all villages the local elites control a large share of the market channels connecting (he village to the surrounding economy. On the one hand they have invested in the outgoing channels through which agricultural produce is funneled: and on the other hand they have a large stake in the ingoing channels via which capital and consumer goods intermediates find their way into the village.

An especially lucrative trade has developed around the ever-increasing stream of mass consumer goods (soap, matches, lottery tickets, kerosene, packed snacks, cooking oil, Soft drinks, condiments, etc.) entering the village (a development pointedly described in Dannhaeuser 1987).

Another expanding trade has been in (lie housing sector, where a considerable trade in intermediates (cement, bricks) and final goods (furniture, appliances) has developed. The hulk of investments in these activity are directed to building up a stock of working capital. Fixed capital investments (in sales premises, transport equipment, storage space) figure much less prominently.

Thirdly, surplus transfers in the form of investments in secondary sector activities are negligible or non-existent. Elite investments in industry are limited to simple agro-processing (rice milling). Small-scale food processing activities other than rice milling attract no elite investments. In two cases, fish processing in one village and the preparation of cassava cakes in another village, production is only undertaken by nun elite households on a minute scale.

B. Employment effects of investment strategies

In respect to the employment effects of agrarian elite investment strategies the following conclusions may be drawn.

1. In a village context employment effects of investments in the important rice sector (including production, agro-processing and trade) have been neutral or slightly positive at most. Labor displacement in on farm (e.g. by the introduction of tractors) has not been offset by investments of surpluses in upstream and downstream markets which have been of a labor-extensive nature.
2. On the other hand agricultural diversification by rural elites into high-value products (shrimps, vegetables, fish, etc.) has creating and is creating many new local on-farm jobs.
3. The record for local non-farm employment creation of agrarian elite business strategies is poor Investment flows out of agriculture have been directed primarily lo labor-extensive trading and transport undertakings. Only investments in rice-milling have had some impact on the local non-farm labor market.

It needs to be remarked here that if we broaden our focus to include also employment effects outside of the direct village context, the non-firm employment multiplier effect of elite investments appear to be stronger If the scope is widened to include neighboring sub-district towns and the smaller district capitals, many effects which were dismissed as leakages before appear in the picture.

This wider rural impact was an issue that was not broached directly in the research. Nevertheless there are many indications that wider linkages are significant. We refer here to the sales and services related to durable and capital goods (tv-sets, cars, motorcycles, rice hulled, compressors, tractors), to trade in agricultural inputs, to Financial services, and Other transactions generated by elite expenditures.

IV. Policy Implications

A. Capital

Intervention in rural industry fusing solely on capital needs wilt in many eases be ineffective Many rural industries are plagued by a combination of problems including overproduction, limited market access, capital scarcity and a lack of technical know-how. Success is only possible when these problems arc tackled jointly in an integrated approach.

B. Credit

The banking deregulation has a visibly positive effect on business in the countryside. Banks demonstrate a clear bias - dictated by transaction cost considerations – toward.

the larger enterprises, especially those operating in the export oriented rural industry sector. Interlinked buy-and-sell cum credit relationships between producers, traders, wholesalers, and suppliers pervade all sectors of the rural economy and represent the dominant source of informal credit. Smaller enterprises facing liquidity problems must rely on these arrangements. The credit relationships are not automatically an inferior substitute for formal sector credit: their casts and benefits should be evaluated on a case-by-ca.se basis, taking into account bargaining positions of lenders and borrowers and the limits of formal financial services.

C. Investment patterns and non farm sector development

In their investment patterns rural elites fall far from realizing the non-farm employment generating potential of assets renting in their hands. The main constraint to a further diversification into nun-farm sector activities, which would be profitable from a private viewpoint as well, is limited information. Human capital formation is there-lore a high priority. Technical extension programs - already in existence in many small industry centers - and market in information services will not suffice to remove this bottleneck and broaden the present narrow base of the rural non-farm sector. Without exception, report’s on successful growth cases in other Asian mention a high-quality educational infrastructure as a necessary springboard for rural non-farm sector development. At present this educational base, in so far as it exists, is unsuited to such a task. Hence there is an urgent need for policy changes and investments in the field of education.