

Some Lessons And Suggestions

Although, as described, the country experience of rural development varies substantially, it is possible to draw some broad lessons for the developing economies and middle-income countries that attempt to achieve inclusive rural development.

Sustained overall economic growth is necessary. The most important lesson of the development history of developed and most developing countries are that high and consistent overall economic growth is the single most powerful mechanism to generate sustainable rural development and reduce poverty.²¹⁰ Sustained overall economic growth not only provides more productive employment opportunities for the rural population but also generates government revenues that can be used to provide public services critical for rural economic growth and development. This has been true for the developed OECD countries; middle-income countries such as the PRC, India, and Malaysia; and for the developing countries.

Sustained overall economic growth alone is not sufficient. A clear strategy is needed to harness consistently the full potential of overall economic growth for inclusive rural development. And overall economic growth can be made to be more pro-poor. Promoting the capacity of poor and low-income households to participate in the growth process should be a central element of such a strategy. The growth needs to create increasing employment opportunities particularly for the unskilled and semiskilled labor in poor and low-income households. The pattern of growth is critically important for

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²¹⁰ Snowdon. 2006; Rosegrant and Hazell. 2000.

inclusive rural development. The resources that economic growth generates for the government must be used productively to facilitate inclusive growth. Without this, overall economic growth will increase rather than reduce urban–rural dualism, and contribute to significant sectoral and regional imbalances in income levels and development.

Rural economic growth is essential. Just as overall economic growth is the best broader strategy to reduce rural poverty and develop the rural sector, economic growth within the rural economy is also the best strategy to promote rural development and reduce potential for significant inequalities between the urban and rural sectors, disparities between regions, and within the rural economy. The policy makers in most countries are concerned about the development gap between urban and rural areas and within rural areas. These differences (inter-sectoral, intra-sectoral, and regional) reflect two major factors: first is the divergence in sectoral growth rates between the rural economy and the rest of the economy and between different regions; second is the inequitable pattern of economic growth within the rural economy. Overall rural economic growth is a result of agricultural growth and the growth in the rural nonfarm economy. Hence, it is essential to pay attention to both the agricultural and the rural nonfarm economies to achieve higher growth rates in the rural economy. In addition, the pattern of growth in each subsector needs to be made more pro-poor to make rural development inclusive. Employment elasticity of growth remains a key factor.

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Although many scholars seem to argue that the “solution to rural poverty does not lie in agriculture,”²¹¹ it is premature for many countries to overlook the importance of agricultural growth to overall rural economic growth and to broad-based rural development and poverty reduction.²¹² First, despite the process of economic transformation, agriculture accounts for a significant

²¹¹ Rigg, 2006.

²¹² One can even argue that part of the rural development problem in most Asian developing economies relates to the premature neglect of investments in the agricultural sector. According to Bolt (2004), during 1972–1979, growth in government expenditure on agriculture in South and Southeast Asia averaged 9.5% a year and this fell to less than 1% between 1990 and 1993. Rosegrant and Hazell (2000) also emphasize the significant decline in investment in agriculture in Asia during 1980s and 1990s. According to Thorat and Fan (2007), India’s public spending in agriculture decelerated at a rate of 3.89% per annum during the 1980s, and this trend continued into the 1990s. According to Lipton (1977), underinvestment in agriculture has been a perennial issue since the 1960s and a clear result of urban-biased government policies.

share of GDP in some Asian countries. Second, although the importance of the rural nonfarm economy has increased in most countries, its dynamism is linked to the farm economy in significant ways. The urban sector growth can be a major driver of the rural nonfarm economy in a transforming economy where the relative share of agriculture in GDP is small. In other economies where this share continues to be high, rural nonfarm economy is driven mainly by the agricultural growth. Hence, lackluster agricultural growth will dampen the growth of the rural nonfarm economy with consequent adverse effects on the poor households. Third, evidence in most developing countries indicates that there is a significant “practice gap” in agriculture: the available knowledge about yield increasing or cost reducing simple agricultural practices is not used extensively for a variety of reasons. For example, many farmers continue to use substandard seed for cultivation, water use in farming remains inefficient, and zero tillage is not widely practiced. Low agricultural productivity is a major cause of rural poverty in countries with relatively large agriculture sectors. Fourth, although some progress has been evident in recent years, a number of crops critical for the welfare of the households of poor farmers have received relatively little research and extension attention. Addressing these issues will improve the links between agriculture and poverty reduction in rural areas. In addition, agricultural growth can significantly and positively impact on social development because when their incomes begin to rise, farm households tend to increase investment in children’s education.

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Protection of the environment is critical. Rapid growth in some Asian economies has been associated with high environmental costs in terms of heavily polluted air, water, degraded land, and other natural resources. Ignoring environmental consequences has a far-reaching, adverse impact on the quality of life of rural people in general and poor households in particular because their ability to cope with such negative developments is severely limited. Negative environmental developments will also constrain overall economic growth in the medium to long term

and hurt the rural poor. In addition, the poor quality of rural environment reinforces the perception among rural people that the countryside is somewhere to escape from. Therefore, it is vital to pay more attention to the environmental consequences of growth. Development must include measures to improve resource use efficiency in agriculture and the rural nonfarm economy. Efforts to address land degradation and desertification,

improve water management, energy efficiency, and air quality need to be strengthened because they are fundamental to inclusive rural development.

The root causes of rural underdevelopment must be addressed. The relatively low economic growth in the rural sector in many Asian developing economies results largely from relatively low growth rates in the agricultural sector, and the rural population's inability to harness the full potential of the rural nonfarm economy. However, the root causes of both these outcomes are different and more important from a policy point of view. The root causes include a combination of factors. The experience of rural development tends to suggest that policies and programs need to focus on root causes rather than proximate causes to achieve inclusive rural development.²¹³

To achieve inclusive rural development objectives, many Asian economies need to focus on a number of root causes. First is the combination of small farm holdings, inadequate land tenure security, and absence of dynamic land rental markets. The average farm size in the PRC, for example, remains too small, around 0.53 hectares for most farm families.²¹⁴ Land rental markets are less developed. The national household survey of 2003 showed that only a small proportion of households are renting land. At the initial stages, new technology tends to be scale neutral. However, over time when production becomes increasingly sophisticated and more market oriented, farm size has to expand to accommodate the application of new technology. The scale economies tend to become more important when agriculture is shifting to high-value agricultural products in response to changing demand.

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Although some governments in the region have made progress in promoting land tenure security in the past decade, much remains to be done. More than 40% of the rural people in Asia live under informal tenure systems and insecure land rights.²¹⁵ For example, although the PRC has made adequate progress in land tenure through the new Rural Land Contracting Law where fully implemented, many villages still do not provide full security of land tenure.²¹⁶ According to some estimates,²¹⁷ Chinese farmers' incomes

²¹³ Bolt. 2005.

²¹⁴ Huang, et al. 2005, 152.

²¹⁵ Bolt. 2004, 3.

²¹⁶ CCICED ARDTF. 2005d, 314–315.

²¹⁷ Prosterman R. and B. Schwarzwalder. 2004, A9.

from agriculture could be raised by 25-65% during the first 5 years if the law is fully implemented, adding an additional CNY250–670 billion to the rural economy without draining resource from other sectors. The Land Management Law’s definition of land as “collectively owned” is unclear in practice. This is creating conflicts between farmers and local authorities when the latter acquire land for nonagricultural purposes. More secure land tenure systems can lead to substantial improvements in agricultural productivity in many countries and significantly contribute to inclusive rural development.²¹⁸

The second root cause in a number of countries such as India, Nepal, Pakistan, and Philippines is the high rate of population growth. The high population density in rural areas caused by the high rate of population growth in the context of already small landholdings make agricultural development more difficult and inadequate for poverty reduction. High population growth rates also put tremendous pressure on government budgetary resources and makes social development including provision of basic health services more challenging.

The third root cause is the inadequate physical and social infrastructure. Despite the need to increase such investments, the response of many Asian economies to this has been sluggish.

Physical infrastructure deficiencies in rural areas need to be addressed not only to create economic opportunities for rural people in general but also to make economic growth and development inclusive and ensure that rural poor have better access to basic services that profoundly impact on their household welfare. High quality social infrastructure reduces bad inequalities which tend to dampen inclusiveness of rural economic growth. While priority setting for infrastructure investment is complicated, priorities for targeting infrastructure investment should be guided by at least three criteria: population density, agricultural and rural nonfarm economic development potentials, including potential market integration and likely positive impact of social development of otherwise excluded people.²¹⁹

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²¹⁸ Anwar et al. (2004, 869) argue that “high concentration of landownership and unfair tenancy contracts are major obstacles to agricultural growth and alleviation of poverty” in Pakistan where the incidence of poverty is the highest among the landless in rural areas.

²¹⁹ Rosegrant and Hazell. 2000, 386.

In social infrastructure development, governments have to pay particular attention to health and education if they are serious about inclusive rural development not only because of their intrinsic value but also for their instrumental value in contributing to improvements in income. The poorer segments and women in the rural societies clearly suffer disproportionately from deficiencies in both health and education services.²²⁰ Addressing pervasive gender inequalities in rural areas is particularly important because such inequalities significantly constrain growth and social development, including prospects for building more egalitarian societies. The fact that Viet Nam and Bangladesh has significantly reduced child mortality in recent years and the state of Kerala and Sri Lanka have achieved high levels of coverage in child immunization, literacy, and many other social indicators with comparatively low average levels of per capita income suggests the feasibility for marked improvement in social inequalities in many Asian countries.

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The fourth root cause is the lack of effective institutions in rural areas. Effective institutions played a major role in many now-developed and developing economies not only in economic growth and sustainable development but also in making growth more inclusive, particularly in rural areas. Effective institutions facilitate enforcement of property rights, constrain the actions of elites and other powerful groups that are likely to create an uneven playing field, make opportunities more equal for broad segments of society, and foster social environment assets.²²¹ Effective institutions are also critical for ensuring poor and low-income households' access to a range of basic services such as safe drinking water, sanitation facilities, health, and education. Effective institutions are particularly important in most Asian economies because millions of small farms and micro and small nonfarm enterprises dominate the rural economy, whose growth and development require a range of direct interventions. These interventions must be coordinated and the quality of their implementation improved.

²²⁰ ADB. 2006a.

²²¹ Eigen-Zucchi et al. 2003; Acemoglu, 2003. 27.

From the point of view of inclusive rural development, five kinds of institutions require urgent attention.

While the performance of many kinds of existing institutions must improve, from the point of view of inclusive rural development, five kinds of institutions require urgent attention because of their broader and crosscutting implications and potential positive impact on the poor and low-income households. These include the institutions that maintain law and order, enforce laws, and ensure justice; rural financial institutions; institutions that efficiently and effectively deliver basic services such as clean water and sanitation, education and health services; and broader civil society organizations that promote inclusive development in a variety of ways.

Effective local level institutions that enforce laws and ensure justice are crucial for inclusive rural development. Without such institutions, disadvantaged groups such as women, people with low literacy and education, and ethnic minorities will find it difficult to protect themselves from misuse of power by those who are socially and economically relatively better off, and politically more powerful. If local law enforcement agencies are effective, the poor and the excluded will be able to use the law to increase the control that they have over their lives and reduce their vulnerability to misuse of power by the others to inflict welfare losses on them. In addition, such institutions have considerable positive impact on the risks and costs associated with socioeconomic activities of the poor and other disadvantaged groups in rural society. They can also improve poor people's access to basic services that state agencies provide.

Another type of institutions critical for inclusive rural development is rural financial institutions. However, as concluded in ADB's Rural Asia study,²²² rural financial markets in Asia are ill prepared for the 21st century. Although this conclusion was reached in 2000, it continues to remain valid. Rural financial institutions are particularly inadequate to meet the requirements for inclusive rural development. A majority of the rural households, particularly the poor and low-income households, do not have easy and reliable access to institutional rural financial services at reasonable costs. A significant proportion of the poor in the region is therefore compelled to rely on either self-financing or informal sources of finance to meet their demand for credit. Without access to credit at reasonable costs, many poor and low-income households forego potentially remunerative investment opportunities, and

²²² Meyer and Nagarajan. 2000, 1.

are denied opportunities to participate in and benefit from rural economic growth. Thus, they are compelled to remain in poverty.²²³ Most rural financial institutions do not allocate financial resources effectively and efficiently, nor do they provide opportunities for rural people to manage their risks prudently, and they exclude a majority of the poor and low-income households. At the same time, many rural financial institutions transfer resources from rural areas through the rural financial system.²²⁴ Although governments in most Asian countries in the past have spent vast amounts of money for rural finance development in the form of frequent injections of funds to recapitalize financial institutions providing rural finance, interest rate subsidies, and unrecovered rural credit of state-owned financial institutions, this strategy is now widely agreed to be flawed and not sustainable.

The international experience provides strong evidence on the important role of dynamic rural financial markets for shared growth, particularly for the rapid growth of the rural nonfarm economy and broad-based development of high-value agriculture. There is an urgent need, in particular, to substantially expand the scope of financial services and increase their scale of outreach to poor and low-income households and their micro and small enterprises.

Institutional diversity, efficiency, and competition in rural financial markets must be promoted. For this purpose, most Asian developing economies may adopt a number of measures. First, the governments need to consider the gradual opening of rural financial markets to foreign investment. This can be done initially by providing preferred entry status to a few carefully selected, internationally reputed and proven rural financial institutions to operate in selected regions within the regulated financial system. Second, a more liberal operational environment may be created for international nongovernment organizations (NGOs) to operate in countries where there are restrictions on operations of such organizations in rural financial markets. Third, incentives should be provided to both local and international commercial banks that are willing and able to penetrate rural financial markets to expand their operations into rural areas. Fourth, effective programs need to be introduced to reform state-owned rural financial institutions including rural development and

²²³ According to Chaudhuri and Ravallion (2007, 195) credit market failures often lie at the root of the problem of poverty and inequality because poor people tend to be most constrained in financing lumpy investments in human and physical capital. In the early 1970s, McKinnon (1973) also argued that access to credit is critical for poor households to adopt even the simplest and most productive innovation and to shift from low-productive activities.

McKinnon noted that lack of access to credit biases their investment strategy toward marginal variations within the traditional technology.

²²⁴ Huang et al. 2006.

agricultural banks, savings banks, postal savings institutions, and financial cooperatives that do not operate effectively and sustainably. The potential of these institutional modalities to serve rural people including low-income households can be unlocked through appropriate reform measures. Fifth, an effective supervisory and regulatory system for rural finance needs to be put in place. Sixth, any existing ceilings on interest rates on rural credit should be removed and clear policy statements issued to convince potential investors that no such ceilings will be imposed in future.²²⁵

Another type of organizations that is essential for inclusive rural development is community-based organizations. CBOs can significantly contribute to promote both equity and inclusiveness in rural development in various ways. First, CBOs can provide opportunities for excluded groups of rural people to exert a degree of command over allocation and use of resources for rural development. Second, CBOs can reduce the potential for possible corruption, malpractices, misuse of resources, and improve transparency, accountability, and efficiency of resource use.²²⁶ Third, CBOs can empower excluded groups and thereby address the issue of powerlessness of the rural poor, an important characteristic leading to social and economic exclusion. Fourth, CBOs can be particularly effective in ensuring access to basic public services such as health and extension to people in remote rural areas and reduce transaction costs and risks associated with providing a range of other services to those in such areas.

The development of broader civil society organizations also requires urgent attention. Civil society organizations can play a potentially large role in the new market economy in rural areas to translate economic growth into development for majority of the rural population, particularly the poor. They can also contribute to reduce the non-income dimensions of rural poverty. In addition, these organizations can promote sustainable development in various ways. Rural development experience in OECD countries and an increasing number of developing countries provide strong evidence on this. Such

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²²⁵ Although absence of the interest rate ceilings have significantly facilitated the growth of the microfinance industry, in recent years many countries have begun to impose ceilings on microcredit interest rates. The ceilings will constrain the industry growth and most likely hurt the poor and low-income households who require access to financial services (Fernando, 2006).

²²⁶ In the state of Kerala in India, for example, CBOs have had a significant impact on improvement of resource use by local level institutions.

organizations can be more useful in social development, implementation of social safety net programs for the poor and other vulnerable groups, disaster management, and implementation of environmental protection programs. Governments need to provide a relatively more liberal environment for, and establish partnerships with, NGOs to operate in rural areas.²²⁷ BRAC in Bangladesh undoubtedly provides the best example of what an efficiently run NGO could do to promote inclusive rural development.

Two other areas need focused attention to achieve inclusive rural development. The first of these is labor mobility.

Two other areas need focused attention to achieve inclusive rural development. The first of these is labor mobility. The countries with sizable agricultural sectors have achieved the most dramatic impact on more equitable rural development and rural poverty reduction by facilitating mobility of labor from agricultural occupations to other more productive economic activities in the urban sector and in the rural nonfarm sector as the economy gets moving and more diversified. This is borne out by the experience in virtually all developed countries, and other countries at various stages of the continuum of economic transformation.²²⁸ As Michael Spence, 2001 Nobel laureate in economics, points out²²⁹ “this movement of labor geographically and across sectors is not an ancillary side effect of the growth process, but rather the essence of it.” The impact of off-farm migration could be appreciated better if we think of the counterfactual—what the income, poverty levels, and quality of life of rural people would have been in the absence of such migration in some countries.²³⁰ The PRC has experienced the most dramatic off-farm migration following the relaxation of controls on labor migration since 1989. More than 100 million migrants now live and work outside their home villages. This migration flow has resulted in large-scale poverty reduction, and created less urban–rural dualism than otherwise would have been the case. The migration has generated a regular flow of remittances from urban to rural

²²⁷ There is a tendency to assume that NGOs are efficient and effective institutions. However, evidence does not seem to support this general assumption. While many NGOs are effective and efficient, far too many are ineffective and inefficient (Herzlinger 1994); hence, the need to be selective.

²²⁸ According to Ravallion and Chen (referred to in Chaudhuri and Ravallion [2007, 186]), 23% of the reduction in the headcount index that occurred in the PRC between 1981 and 2001 is attributable to the population shift from rural to urban areas.

²²⁹ Spence, 2007.

²³⁰ Mundlak, 2005, 1017.

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areas. The amount remitted from urban to rural areas is estimated to be in the range of \$20 billion to \$30 billion a year. Remittances are a major source of rural household income in many other countries.

However, an important lesson from the international experience is that it is important to synchronize this labor transfer to ensure productive use of labor and to prevent transfer of socioeconomic problems from one sector to the other with off-farm migration. It is a major development challenge. While perfect synchronization of transfer of labor is not possible, some countries have pursued successful policies to improve synchronization. These measures

fall into two categories: those reducing risks of labor transfer, and those reducing transaction costs of labor transfer. An effective way to reduce risks in the medium to long term is to ensure universal primary and secondary education as early as possible. The experience of Japan, Taipei, China and the ROK highlights this. Another way is to pay more attention to special skills training for those who are already in the labor force to enhance their employability outside the agricultural sector. Programs to eliminate illiteracy among adults can also contribute toward this objective. Governments can also introduce measures to reduce transaction costs of labor transfer by improving conditions for migrant labor in terms of educational facilities for children, access to health facilities, and reasonable housing for migrant families. In countries such as the PRC and India where land rental markets are deficient and at early stages of development, measures to improve farmland rental markets will also reduce risks and transaction costs of migration and facilitate mobility of labor from agriculture to nonagricultural activities.

The other area that requires special attention is development of “the less favored areas.” This is a major lesson of the rural development experience in most countries. The less favored areas (LFAs) are characterized generally “by lower agricultural potential, often because of poorer soils, shorter growing seasons, and lower and uncertain rainfall, but also because past neglect has left them with limited infrastructure and poor access to markets.”²³¹ The poor in LFAs suffer from multiple, interlocking disadvantages that badly place them either to seize local economic opportunities or to migrate to distant areas. This is an important problem in India, PRC, and Viet Nam because majority of the rural poor live in such areas. While the poor in these

²³¹ Rosegrant and Hazell. 2000, 323.

areas may benefit to some extent from migration and growth in high-potential areas, the rationale for neglecting the LFAs is increasingly challenged.²³² While policy makers must avoid inadvertently locking too many people into marginal areas where their long-term prospects are limited, for many less-developed areas, agricultural intensification must be a key component of their rural development strategy. This requires strengthening participatory and multidisciplinary agricultural research on LFAs, effective extension services, development of local institutions, introduction of area-specific risk mitigation and safety-net programs, and public investment in infrastructure development. The investment in LFAs may be justified based on their significant social benefits in the form of poverty alleviation and improved environmental management.²³³ In addition, it is important to improve their ability to migrate for more productive employment elsewhere.

²³² Rosegrant and Hazell. 2000, 329, 334, 344.

²³³ de Haan and Lipton, 1998.