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Accelerating Agriculture and Rural Development for Inclusive Growth: Policy Implications for Developing Asia

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Introduction

Developing Asia stands witness to the impact of economic growth on poverty reduction. The incomes and quality of life for many people have improved and poverty levels are falling. But results vary with rural growth lagging behind urban growth in many countries and subregions. Two thirds of the region's 3 billion people live in rural areas, and in India, for example, 74 percent of people classified as poor are in rural areas (ADB 2004). The difference in urban and rural growth and poverty outcomes is socially and politically untenable, as witnessed in the recent election in India. Rural poverty problems in many cases become urban poverty problems through rising pressure on cities to absorb rural migrants needing jobs, homes, and services.

What underlies this situation? Pre-1980s, the rural economic problem was commonly seen as undersupply of affordable food and raw materials to support industrialization as the engine of rapid growth. The strategy greatly influenced the design and choice of public policies. Overvalued exchange rates were intended to help new industries establish domestic markets and lower costs of imported materials, but lowered the domestic currency earnings for farmers in export markets. Administered food prices lowered consumer prices but lowered returns to farmers as well. Agricultural commodities and land were heavily taxed to force the transfer of resources out of rural areas. Farm input subsidies encourage production of food crops but lead to resource wastage, and often benefit well-to-do farmers. Such policy biases lower agriculture's terms of trade, distort market signals, and undermine agricultural growth (Krueger 1992).

Price and trade policy reforms through the 1990s offered a significant window of opportunity for improving incentives and developing agriculture and the rural economy. But serious institutional and infrastructure constraints remain. Unless these constraints are addressed and the agriculture and rural economy actively developed rapid poverty reduction cannot be attained.

This brief outlines the potential for agriculture and rural development as a critical force for inclusive growth and sustained poverty reduction and reviews experiences in the Asian region with agriculture in economic transformation. It highlights major policy challenges for accelerating agriculture and rural development.

Agriculture and Rural Economy at the Core of Inclusive Growth

A large proportion of the population in developing Asia is rural-based and depends on agriculture for a living. Rural productivity, employment, and income growth are critical drivers for lifting the national economy. There is significant potential and opportunity for agriculture and the rural economy to grow in a healthy reinforcing environment. The rural-based cycle starts with productivity increases driven by yield-improving technologies that allow surplus production of, at first, food. The surplus is sold to local rural markets as the immediate outlet. The extra income is spent on local products, generating further rural employment and income increases. As incomes rise, middle-income group demand rises for higher-value farm and nonfarm goods and services, providing incentives for diversifying into higher-value commodities and nonfarm goods and services. Growing nonfarm goods and services then attract labor with higher wages in tightening labor markets, encouraging farmers to raise productivity with labor-saving technology. Increasingly, surplus production of basic and higher-value commodities find markets beyond the area, including accessible export markets, further stimulating productivity (Mellor 1995). So, through production, employment and consumption linkages, agriculture and the rural economy reinforce each other, leading to economywide growth in employment, incomes, and poverty reduction.

Impact estimates of successful agriculture and rural-based growth cycles are impressive. Roughly half of rural incomes are spent on locally produced, labor-intensive, nontradable goods and services. Around 40 percent of the income rise from agricultural productivity increases are spent on locally produced, labor-intensive nonfarm goods and services. Employment created from rural nonfarm goods and service production is estimated to be twice that from farm productivity increases, with a 10 percent rise from nonfarm production creating a 15 percent rise in jobs (Mellor 1999).

A virtuous agricultural growth cycle, as described, provides a strong base to support economic transformation. Success in the agriculture sector usually leads to its proportional decline in the economy. Economic transformation is inevitable. But this does not mean that rural productivity and incomes have to be left behind as the nonagriculture economy grows. A stagnant rural economy and agriculture sector can exert a heavy toll to smooth transformation, witnessing massive migration of unemployed poor to urban areas.

Strong agricultural growth contributed to industrialization in Republic of Korea and Taipei,China, where urban and rural per capita incomes have grown at comparable levels. People's Republic of China and India's vast rural populations have benefited from production expansion and rising productivity. But in these latter economies, regional and sector disparities are widening on account of rural growth significantly lagging behind fast-growing urban areas. During the 1990s, rapid industrial and urban growth compared to low, erratic, or stagnant rural growth resulted in urban incomes exceeding rural incomes by, for example, 10 times in Thailand, 4 times in Indonesia, and 3 times in the Philippines (Butzer et al. 2003).

Same Challenge, Some Remaining Constraints

Rural underemployment, urban rural growth and income differences, and overburdened cities refocus the challenge to accelerate rural growth and achieve overall inclusive growth. Past policy lessons highlight the importance of the right incentives and well-functioning markets to increase productivity, employment, incomes, and demand. That is, an environment for rapid rural response. The enabling environment includes incentives for farm and rural enterprises to raise farm and enterprise productivity; public and private institutions that ensure factor and product markets to work; and infrastructure connectivity to expand markets. The policy agenda for improving incentives, institutions, and infrastructure is significant and country-specific. Key components are highlighted as follows.

Most of the Asian region's productive land has been brought into production, so land productivity improvement is key to further agricultural growth. Poorly working land markets can skew distribution, limit access by more efficient producers, and lower productivity. Poorly defined land rights, insecure tenure, above market-rate rents, and biased tenancy arrangement are key disincentives to productivity and investment. More than 40 percent of the rural people in Asia live under informal tenure systems and insecure land rights. Clear land rights can double investment in land (Deininger et al. 2003). Unclear user rights for land and common property resources such as water and rangelands can lead to resource degradation. Policy and institutional reform efforts range from clarifying land rights definition and improved ownership equality, to better land management and administration. But limited institution capacity, corruption, and slow titling processes delay potential productivity gains and urgently needed loss avoidance on deteriorating lands. Good practices have been developed but need to be replicated or adapted to the local context.

Closely related to the land policy environment are labor market concerns. Tenancy arrangements such as sharecropping in South and Southeast Asia increase with land ownership inequality. While providing some assurance to tenants, high owner crop shares can lower productivity and lead to labor bondage. Labor market flexibility becomes more important for wage employment and the nonfarm rural economy. Labor market regulation can improve worker insurance and prevent exploitation, but excessive regulation can prevent mobility to more productive enterprises. In addition to formal regulations, the rural economy may also be confronted with many informal barriers to employment. Efforts are under way to balance labor rights and increase productivity, but are often politically charged and subject to slow bureaucratic or corrupt labor inspection practices.

Access to finance is essential for farm and nonfarm production given agriculture's seasonality and diversification trend. Rural financial markets are critical in rural economy development, supporting financial intermediation, and risk management. Provision of small-scale farmer credit at subsidized rates through public sector institutions prove unsuccessful. Recent innovations for advancing rural finance stress rural outreach, sustainability, and risk management. Public policy challenges include promoting innovation in product and service mechanisms to cut borrowing risks and costs. Where land and other markets do not work well and the transaction costs of borrowing are high, financial services tend to favor farmers owning larger land areas (Deininger et al. 2003). Clearly, land policy improvements have a significant bearing on rural financial sector reform.

Public goods and services provision such as irrigation, agricultural research, and extension provide farmer access to yield-increasing technology, production know-how, and information on market conditions. From 1972 to 1979 growth in government expenditure on agriculture in South and Southeast Asia averaged 9.5 percent a year. This fell to less than 1 percent between 1990 and 1993. Yet subsidies make up 20 to 60 percent of spending (ADB 2000). Top-down approaches to service delivery, bias toward better-off producers, and lack of central level accountability led to decentralization and greater local service provision in Indonesia and Pakistan. Use of nongovernment and community-based alternatives are options, but successes are context-specific (Mansuri and Rao 2004). Redressing expenditure allocations to agriculture is an urgent matter for governments and donors. Clear expenditure priorities are the basis for improving budget allocations. Service efficiency improvements are needed to reduce wastage and improve impact.

Market expansion depends on physical access to markets and lowering the costs of doing business. Physical access to input and product markets needs infrastructure connectivity. In Indonesia, for example, agribusinesses rank land access, power access, transport, and telecommunications as the main obstacles to setting up production and gaining access to markets (Asian Development Bank and World Bank 2004). Policy and regulatory uncertainty, corruption in routine activities such as licensing and tax paying, excessive labor regulation, uncertain legal systems, and time-consuming bureaucratic red tape raise costs and become significant barriers to entry (ADB 2004). In view of the deeply entrenched vested interests, policy reforms in these cases call for extraordinary levels of political commitment. Paradoxically, essential public services, industry standards, and safety and regulation are not provided or become victims of red tape and corruption. Continued realignment and provision of missing public services is critical.

Conclusion

The evidence is compelling on the potential for regenerating the rural economy by accelerating agriculture and rural development. This is not just for the sake of developing agriculture. Actively tapping agricultural and rural-based opportunities is a critical component of an inclusive growth strategy. Yield-improving technology, and expanding into high-value commodities and nonfarm goods and services value addition, are key to meeting much-expected opportunities for employment and income growth among Asia's predominantly rural population.

Along with the price policy changes of the 1990s emerge the substantial policy agenda for further improving incentives, institutions, and infrastructure. There is no silver bullet for reforms in any one or all markets, and the interconnectedness of individual reforms needs to be considered. By viewing individual reforms as part of a whole, a more realistic assessment can be made of the adjustment process and needs for financing.

Currently stagnant public sector expenditure cannot meet the financing needs for rural infrastructure development and rural public service provision. Budget reprioritization and service efficiency improvements need to be urgently addressed. Past public support has fallen prey to wasteful transfers, undermining inclusive growth prospects.

Accelerating and sustaining the region's impressive overall growth depends on accelerating agriculture and rural development efforts for inclusive growth.

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