



Forum on

## Inclusive Growth and Poverty Reduction in the New Asia and Pacific

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### Session 5A: Inclusive Pattern of Growth – Panel Contribution

## Growth Processes and the Rural Urban Divide

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During the process of economic growth, agriculture's share of national output shrinks. The faster the growth, the faster this structural realignment becomes. Two kinds of economic forces produce this outcome. On the demand side, the share of expenditure devoted to food declines as incomes rise. If the composition of output does not respond rapidly enough to this changing pattern of expenditure, the result is a decline in the price of food relative to other goods, reflected in a decline in the agricultural sector's terms of trade relative to other sectors of the economy. This price movement reduces rural incomes and accelerates the rate of adjustment of output. On the supply side, the process of capital accumulation, the principal driver of the growth process, results in the expansion of capital-intensive sectors of the economy, such as manufacturing and some services, and the decline of labor-intensive sectors, such as agriculture.

At the same time as the composition of output changes, the composition of employment also changes. Agricultural employment contracts as a proportion of total employment, but this process occurs more gradually than the realignment of the composition of output. 'Adjustment' of the composition of employment largely means movement of people from rural to urban areas. Rural non-agricultural employment is an important phenomenon, but throughout the Asia-Pacific area the growth of non-agricultural employment still tends to be concentrated in urban areas. Movement of people from rural to urban areas tends to be painful. Ties with the land and with rural traditions are severed only reluctantly. In consequence, people move out of agriculture more slowly than the readjustment of the composition of output would dictate.

The combined result of these two phenomena is that as economic growth proceeds, the share of agriculture in total output exceeds its share of employment. For example, in Thailand, agriculture's share of GDP is now about 10 per cent, but its share of employment is over 30 per cent. This discrepancy between agriculture's share of national income and its share of employment is reflected in much lower levels of real income in rural areas than in the urban population - even after adjusting for differences in the cost of living. Another way of stating this phenomenon is that in rapidly growing economies there tend to be too many farmers. Those who remain in farming are much more likely to be poor than those who do not.

Although the process of economic growth raises average incomes and reduces the incidence of poverty at a national level, urban poverty declines more rapidly than rural poverty. The result is the well-known 'rural-urban divide'. The incidence of poverty is much higher in rural areas than in urban areas and the discrepancy tends to increase over time. Taking the example of Thailand again, 92 per cent of all poor people in that country, according to the official poverty line, now live in rural areas, but these areas share of the total population is under 70 per cent. This situation is typical of East Asia. Table 1 below shows that the concentration of poverty in rural areas is greater in East Asia than any other developing region of the world.

Table 1 Rural and Urban Poverty at Poverty Line of \$1 a Day, 2002

	Number of poor (millions)			Headcount index (%)			Rural share of poor (%)	Rural share of population (%)
	Urban	Rural	Total	Urban	Rural	Total		
East Asia/Pacific	15.8	217.8	233.6	2.2	19.8	13.0	93.5	68.9
Latin America/Caribbean	38.3	26.6	64.9	9.5	21.2	12.3	41.0	23.8
Middle East/North Africa	1.2	4.9	6.1	0.8	3.8	2.1	80.1	44.2
South Asia	134.8	407.0	541.8	34.6	40.3	38.7	75.1	72.2
Sub-Saharan Africa	98.8	228.8	327.6	40.4	50.9	47.2	69.8	64.8

Source: Ravallion, Chen and Sangraula (2007).

The migration of rural people to the urban growth centers raises the productivity of the people concerned and reduces poverty. Rural-urban migration is sometimes seen as a problem to be avoided by policy, but this is a mistake. Although the process produces serious social and economic problems, the path out of poverty for a high proportion of rural people leads out of agriculture and out of rural areas altogether. It is essential that governments act to mitigate the negative effects of rural-urban migration, but the fundamental cause of persistent rural poverty is that the process of rural to urban migration does not occur rapidly enough. The problem is not that rural-urban migration is too rapid, but that it is too slow.

Rural-urban migration should be promoted, rather than impeded. Beyond that, what can be done about rural poverty? I shall first describe one kind of policy response that does *not* work and then a set of responses that does. It is tempting to see the low level of real incomes in rural areas as a problem of price policy. According to this way of looking at things, it is necessary to address rural poverty by introducing policies that make agricultural production more profitable. In food importing countries, this generally takes the form of protecting domestic agricultural producers against imported food, using tariffs and/or quantitative restrictions to raise the domestic prices of these imported commodities. For example, in Indonesia, protection of the domestic rice industry against rice imports has increased the domestic price of rice substantially. Since the year 2000, when import controls were introduced, the domestic price of rice has increased relative to other prices by at least 40 per cent.

Unfortunately, agricultural protectionism does not reduce poverty. It increases it. To see the reason for this, consider the effect of an increase in domestic food prices on producers and then on consumers. An increase in food prices benefits producers who are net sellers of the commodity concerned. But this benefit is concentrated on the largest producers, the largest land-owners. These are the richest farmers. Subsistence producers do not benefit at all, because they both produce and consume rice. On the other hand, the increase in food prices harms the poorest consumers disproportionately, because the poorest people spend the highest proportion of their incomes on staple foods. These consumers include all rural people who are not net sellers of the commodity concerned. In particular, it includes landless laborers, who obtain their incomes from selling their labor. They are buyers of staple foods, not sellers. Agricultural protection benefits the largest farmers at the expense of the poorest consumers. Based on my modeling work agricultural protection in Indonesia has increased poverty

incidence by at least 1 per cent of the Indonesian population and increased it in both rural and urban areas (Warr 2005).

What policies do work? To reduce the disparity between rural and urban incomes in a way that reduces, rather than increases total poverty, it is necessary (a) to raise the productivity of rural people and (b) to facilitate the movement of people away from agriculture. Rural education is central to this process. Throughout Asia, rural education is inferior in both quantity and quality to that provided in urban areas. When rural people do relocate to urban areas, their poor levels of education condemn them permanently to the bottom rungs of the urban economic ladder.

Especially in the poorest Asian countries, rural infrastructure tends to be underprovided, lowering the productivity of rural people and making it more costly to get agricultural goods to market. Roads and electricity provision are key examples. Improvements in agricultural technology which raise the productivity of rural labor often depend on public investments in research and extension. Improvements in water management are becoming more important as water becomes increasingly scarce, and these also require public sector action.

Finally, the promotion of private investments in agricultural processing and retail development is to be encouraged because these investments raise the competitiveness of domestic agricultural goods. However, these developments themselves require adjustments on the part of agricultural producers, who must meet the higher quality standards demanded by these processors and large scale retailers.

#### **Reference:**

Martin Ravallion, S. Chen and P. Sangraula (2007) 'New Evidence on the Urbanization of Global Poverty', Policy Research Working Paper 4199, World Bank, Washington DC.

Peter Warr (2005) 'Food Policy and Poverty in Indonesia: A General Equilibrium Analysis', *Australian Journal of Agricultural and Resource Economics*, Vol. 49, No. 4, (December), 429-451.

