

## **SYNOPSIS of WORLD DEVELOPMENT REPORT 2008 Calls for Renewed Emphasis on Agriculture for Development**

### **(Specific references to Asian countries)**

In transforming countries, nonagricultural sectors have been the fastest growing in the world. Agriculture in those countries is no longer a major source of economic growth. A distinguishing feature of transforming economies is the widening gap between urban and rural incomes. The reasons are lack of skills, an aging population, rigidities in land and labor markets, and social and community ties.

- 1) The main goal of the agriculture-for-development** agenda is to narrow urban-rural income disparities and reduce rural poverty while avoiding the subsidy and protection traps to support rural incomes. Those challenges have been poorly addressed thus far. With growing political attention to these widening income disparities, there are strong pressures to better use the powers of agriculture for development.
- 2) SMALL FARM SIZE** :In Asia, the average farm size is already quite small. . Continued population growth, declining farm size, and growing landlessness puts huge pressures on rural jobs.
- 3) DEALING WITH WATER SCARCITY.** Water scarcity is particularly acute and projected to worsen with climate change and rising demand. High reliance on groundwater irrigation in many countries has led to over-pumping, falling groundwater tables in aquifers with low recharge, and deteriorating groundwater quality.

Reforming institutions in irrigation, removing policy distortions such as water and electricity subsidies, and providing a supportive environment for trade and macroeconomic policies are all important steps in improving water productivity and meeting competing demands. Broad-based reforms require strong champions and equitable allocation of water rights to overcome the political obstacles. As scarcity worsens, water markets may come into play, with support needed for their emergence and eventual regulation.

- 4) LAGGING AREAS.** Some rural areas have prospered with overall economic growth, but others have stagnated with high levels of poverty. Lagging areas are found in the central India. The causes are varied—poor agricultural potential, low investment in roads and irrigation, poor governance, and social and ethnic marginalization. But some of those areas have good potential for agricultural growth and could be future breadbaskets (as in eastern India).

**Development of lagging areas:** With the shift to the new agriculture and the declining farm size in high potential areas, increasing farm productivity and incomes in less-favored regions can secure the livelihoods of subsistence farmers and bring them to the

market. Productivity growth in these regions rests on major investments in soil and water management, in agricultural research, and in new approaches to extension, supported by reforms in pricing and marketing for grains.

- 5) **POLITICAL ECONOMY AND AGRICULTURAL POLICIES:** The political pressure of farmers to reduce the urban-rural income gap through protection and subsidies is increasing. Because of the large number of poor people, protecting food prices to raise farm incomes may have high costs for poor consumers, including most small farmers, who are net food buyers. Another form of support to farm incomes is through subsidies on inputs such as water and fertilizer. Those subsidies are not only regressive in distributing benefits to larger farmers and harmful to the environment but also distort fiscal priorities away from investment in core public goods, such as rural infrastructure. Political capture of protection and subsidies by larger farmers can slow the reform process.
- 6) **NEW AGRICULTURE:** Rapid growth of urban incomes and demand for high-value products are the major drivers for faster agricultural growth and poverty reduction in transforming countries, although sustainable productivity growth in food staples requires continued attention. Because there are scale economies in processing and marketing of many high-value products, institutional innovations such as contract farming can reduce the transaction costs and risks to smallholders. Linking smallholders to processors and retailers can also create access to more financial capital through banks—and provide technology, extension, and buyback arrangements, while monitoring food safety. A high priority is to improve the investment climate for agribusiness and facilitate collective action through producer organizations to reach scale in marketing and to bargain for better prices. Reform of price and subsidy support to cereals will also be needed in many cases to provide the incentives to diversify to high-value products.
- 7) **OFF FARM ECONOMIC ACTIVITIES LINKED TO TOWNS:** Growth in rural non-farm employment in many cases remains closely linked to growth in agriculture, as agriculture is the main supplier of intermediate inputs to other sectors such as processed foods (forward links). Regional and territorial development of agricultural clusters—with the processing and packaging of high-value products—is an opportunity for rural non-farm development. In densely populated countries, urban-based industries will drive the rural non-farm sector through urban-to-rural subcontracting. Investments in infrastructure and skills and improvements in the investment climate for the private sector are the policy priorities. Developing land market to enable small farms to consolidate for efficient operation and to shift labor to non-farm activities and migration is also a priority.

**Skills for successful migration.** Successfully moving out of agriculture, whether by moving to the rural non-farm sector or by migrating to urban areas, depends on more and better-quality education. Massive investments in human capital are needed to prepare the next generation to leave agriculture. Programs that provide conditional

transfers, such as cash grants in Bangladesh conditioned on school attendance, can increase the demand for education, but they will fail unless the quality of rural education is greatly improved.

- 8) SAFETYNET FOR THOSE LEFT BEHIND:** Transforming countries have the largest concentration of the world's poor, so direct support through well-designed and well-governed employment schemes in rural areas—including rural infrastructure, reforestation, soil conservation structures, small dams, and desilting of canals and ponds—can reduce poverty, improve the rural investment climate, and restore degraded natural resources. Significant monitoring, accountability mechanisms, and rigorous evaluations are needed to ensure effective and equitable resource use.
- 9) AGRICULTURE AND POVERTY REDUCTION:** Seventy-five percent of the world's poor live in rural areas. The evidence that growth in agriculture is on average at least twice as effective in reducing poverty as growth outside agriculture is thus no surprise. Agricultural growth reduces poverty directly, by raising farm incomes, and indirectly, through generating employment and reducing food prices. Pro-poor agricultural growth is centered on small holder farmers who are made more competitive and sustainable through institutional and technological innovations and empowered through producer organizations. These interventions must be complemented by massive investments in rural education to transition into more skill-intensive employment and successful migration.
- 10) Agricultural growth is especially effective in reducing poverty.** Cross-country econometric estimates show that overall GDP growth originating in agriculture is, on average, at least twice as effective in benefiting the poorest half of a country's population as growth generated in nonagricultural sectors. Agriculture was also the key to India's slower but still substantial long-term decline of poverty.

Policies are needed to enhance the pro-poor effects of agricultural growth.

Access to assets. Access to land, water, and human capital critically determine the ability of households to participate in agricultural markets, secure livelihoods in subsistence farming, compete as entrepreneurs in the rural non-farm economy, and find employment in skilled occupations. Yet the rural poor have few of these assets, and their limited asset base is often further eroded by population growth, environmental degradation, expropriation by dominant interests, and social biases in public expenditures. Enhancing assets requires significant public investments in irrigation, health, and education. Increasing assets may also call for affirmative action to equalize chances for disadvantaged or excluded groups, such as women and ethnic minorities.

**11) IMPROVING PRODUCTIVITY** by increased public investment in research and development is needed to ensure design of such pro-poor technologies. Better technologies for soil, water, and livestock management and more sustainable and

resilient agricultural systems, including varieties more tolerant of pests, diseases, and drought, are also especially

Important for subsistence-oriented farmers.

**12) VOICE AND ACCOUNTABILITY:** Giving the poor greater voice in policy decision making and making institutions more accountable to them through decentralization. **Producer organizations** can give political voice to smallholders and hold policy makers and implementing agencies accountable by participating in agricultural policy making, monitoring public expenditures, and engaging in policy implementation. Many high-value activities such as horticulture and dairy farming are labor intensive and generate substantial employment, with significant poverty-reducing effects. Growth in rural non-farm employment such as processed foods is closely linked to growth in agriculture, but it increasingly also originates through urban-rural subcontracting, especially closer to the cities. In an emerging vision of agriculture for development, production is mainly in the hands of smallholders, who can be the most efficient producers, in particular when supported by strong producer organizations.

## **12) Diverging patterns and a mixed picture of rural welfare in India**

Although there is a consistent poverty-reducing pattern across almost all Indian states, growth has been uneven. From 1980 to 2004 initially poorer states grew more slowly, resulting in income divergence in both absolute and relative terms. The rapid trade liberalization of the 1990s had sharply differentiated regional impacts. Rural districts with a higher concentration of industries hurt by liberalization had slower progress in reducing the incidence and depth of poverty because of the extremely limited mobility of labor across regions and industries. Urban incomes and expenditures also increased faster than did rural incomes, resulting in a steady increase in the ratio of urban-to-rural mean real consumption from just below 1.4 in 1983 to about 1.7 in 2000. Even then, India had fairly low income inequality. But despite impressive growth and poverty reduction in the 1990s, the picture of overall welfare gains is nuanced, because health outcomes have not improved. India's recent reforms, unlike China's, were not directed at agriculture. Today, there is a renewed policy focus on agriculture in India, because many believe that the full poverty reduction potential of agriculture in India has yet to be unleashed.

13) Input Subsidies The cost of the subsidies has been high and unsustainable, and the modest benefits generated have been captured by larger farmers. Despite this record, input subsidies continue to have strong support, both from farmers and from politicians who view farmers as an important constituency. Input subsidies can bring economic benefits to society in several ways:

- They can stimulate input market development by offsetting high initial distribution costs until the market expands, economies of scale are realized, and prices decline.

- They can encourage technology adoption and diffusion by reducing the initial risks and costs of learning a new technology.
- They can overcome missing or imperfect credit or insurance markets for farmers that cause cash-limited farmers to use suboptimal amounts of inputs.
- They can offset taxes or output price controls that make the use of purchased inputs financially unprofitable.
- They can generate positive environmental externalities associated with increased soil fertility and soil conservation—reducing soil erosion, deforestation, and carbon emissions.

But input subsidies can also be a major cause of negative environmental externalities when they encourage excessive application of fertilizer and other agricultural chemicals and result in runoff and water pollution (brief on Agriculture and the Environment).

Use of input subsidies to achieve non-economic goals can be justified only if subsidies represent the most cost-effective option for achieving the desired social objective compared with alternative instruments, such as food aid and cash transfers. Whether input subsidies are cheaper than food aid depends on the relative costs to the government of acquiring inputs and food and delivering them to needy households. The cost-effectiveness of subsidies also depends on the additional food output likely to be generated per dollar of input distributed to and used by farmers. In addition, it relies on other cost savings associated with aid through inputs, such as avoiding farm-to-market transport and handling costs incurred when farmers must sell a portion of their crop to repay input loans.

### **13) Input subsidies must be redesigned as “market-smart” subsidies.**

Strategies for promoting increased use of improved inputs should heed the lessons of the past. In practice, it has been difficult to implement input subsidy schemes without exposing governments to extremely high costs and without giving rise to undesirable market and distributional effects. Many of those subsidies went to relatively wealthy farmers rather than to the smallholders whom they were intended to benefit. Meanwhile, investment in core public goods, such as the research and extension needed to increase productivity, has fallen.

### **14) More and Better Investment in Agriculture**

Investing in core public goods pays.

Agricultural growth and poverty reduction depend critically on investments in rural infrastructure (irrigation, roads, transport, power, and telecommunications), as well as on investments in markets, rural finance, and research and extension. Those types of investments generally provide high returns. Average rates of return on investment in agricultural research and extension, for example, have been documented in the range of 35 percent (Sub-Saharan Africa) to 50 percent (Asia) in 700 studies. Those rates are far

above the cost of money accessible to developing countries. Investment in irrigation has also provided high payoffs in Asia. Evidence from rural China, India, and Uganda shows that the highest returns, in terms of both growth and poverty reduction, are from investments in agricultural research, rural roads, and education. In the transforming and urbanized countries of Asia and Latin America, the decline in public funding for agriculture partly reflects agriculture's declining importance in the economy. Nonetheless, reversals have recently occurred in several countries, including China, India, and Mexico, motivated by the need to fight widespread rural poverty and narrow a widening rural-urban income gap.

**“Mis-investment” is pervasive in many countries.**

Underinvestment in agriculture is further compounded by mis-investment— that is, spending on private goods, such as input subsidies and transfers, that benefit richer farmers more. Thus, the quality of public spending—the efficiency and equity of resource use—is often an even more important issue to address than its level. Recent reviews of public expenditures suggest that public budget allocations to subsidies and transfers are high: 75 percent in India. The bias toward subsidies often increases as a country's income rises. In India, for example, agricultural subsidies as a share of agricultural GDP have risen steadily from 1975 to 2002. They have mostly benefited richer farmers. Given scarce fiscal resources, increasing subsidies are often at the expense of high-return investments in public goods.

**15) Ministries of agriculture must adapt to new roles and capacities.**

There is now general agreement that the state must invest in core public goods, such as agricultural research and development, rural roads, property rights, and enforcement of rules and contracts, even in highly industrialized economies. The agriculture-for-development agenda also assigns a strong role to public policy for promoting poverty reduction and equity, including gender equity, by building productive assets and providing safety nets. The agricultural bureaucracies remaining after structural adjustment are particularly weak, however, and lack the capacity to implement the agriculture-for-development agenda in partnership with the private sector and civil society. Likewise, they face challenges in working effectively with local governments, which have gained importance due to decentralization. In most countries, ministries of agriculture are in need of far-reaching reforms to redefine their roles and develop new capacities.

A conducive climate for the private and the third sector is important.

Because a positive rural investment climate is essential for a competitive private agribusiness sector to emerge, investment climate reforms need to pay special attention to the constraints faced by agricultural and rural enterprises. The private sector can also use its expertise and political weight to promote reforms through, for example, public-private dialogues. The third sector comprises producer organizations, nonprofit service

providers, and other civil society organizations. This sector has an important potential to help in overcoming market failures inherent in smallholder agriculture, while avoiding government failures. Producer organizations can facilitate input supply, extension, marketing, and management of common property resources, such as irrigation systems. They can also play a much larger role in setting the national agricultural policy agenda.

In India, dairy cooperatives provide services to more than 12 million households, benefiting women in particular because of their role in dairy farming. And the special competencies of many NGOs can be harnessed to deliver services, especially at the local government and community levels.

#### **16) A need for Sustained and Increasing Investments in Agriculture R&D.**

Agricultural productivity improvements has been closely linked to investments in agricultural R&D. Published estimates of rates of return on R&D and extension investments in the developing world average 43% a year. Despite this high return on investment, agricultural science remains grossly under-funded in developing countries. Global and national market failures continue to induce serious underinvestment in R&D and in related extension systems. In the developing world, private investment in agricultural R&D is very limited – 94% of the investment is from the public sector. But growth in public sector spending has slowed sharply in the past decade and as a share of agricultural GDP, remains a fraction of the public investment in industrialized countries.

Compiled by K. Ramasubba Reddy, Advisor, CIFA.