

Industrial policy for rural areas can be harmful to economic development

The economic case for agglomeration is strong: The production of intermediate and final goods is characterised by increasing returns to scale. Therefore economic development and concentration of production (leading to urbanisation) go hand in hand. The future of the world economy will arguably depend less on economies of scale than its past. New technologies and transitions to service economies might even allow economic activities to de-concentrate to a certain extent. But to hope that today's developing countries can skip the process of industrialisation and concentration and move to a service economy right away seems bold.

Industrial policies for rural areas tend to equalise the spatial distribution of economic activities and thus implicitly fight agglomeration. The question whether industrial policy for rural areas is reasonable is hence not only a question of sub-optimal allocation of limited resources. Spatial equalisation of economic production reduces the potential benefits of scale economies and thus slows down the overall development process.

■ Priority must be given to improving living standards of people

I do not argue in favour of deliberate disconnection of rural areas. But I want to emphasise that the debate "industrial policy for rural areas versus disconnection of rural areas" misses the right alternative. Let's remind ourselves what the ultimate goal of development policy is: We are concerned with the living standards of people and not so much of geographical units. Policy should for various reasons not focus on spatial equalisation of economic production, policy should instead focus on the (spatial) equalisation of living standards. Resources for development should be used in such a way that as many people as possible benefit from them. The passion of development policy for remote areas is thus hard to understand.



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The *World Development Report (WDR) 2009: Reshaping Economic Geography* has developed a policy framework which both fosters (spatially unequal) economic development and spatially equal living standards. It avoids one-size fits all solutions for development and argues convincingly that different stages of development require different policies. First, spatially blind institutions provide basic services, clarify property rights and do not interfere with the accumulation of economic density. This in itself favours rural areas relative to the status quo, because many developing countries have pro urban rather than spatially blind institutions. Second, spatially connective infrastructure (such as transportation or ICT) reduces the economic distance for people commuting or migrating from rural areas to the urban centres as well as for the movement of goods. Third, targeted interventions overcome divisions due to social segregation within and between rural and urban areas alike and fight negative externalities of big cities. A targeted intervention could also mean to facilitate the development of a specific industry in a specific rural area in which the rural area has already developed a small comparative advantage, but it would not include investments that have the sole objective to keep people in areas where they face very little (unsubsidised) prospects for welfare improvements. The approach of the WDR 2009 is not as market liberal or apolitical as it might appear at first sight. In fact, the WDR points out that stopping to fight the windmill of economic concentration will free resources for the creative power of politics and enable targeted interventions at the right stage.

The outlined policy framework is certainly different from what we understand of industrial policy for rural areas in a classical sense, which tends to equalise the spatial distribution of economic activities by attracting economic activities to rural rather than urban areas. This type of industrial policy has failed many times, because first of all it does not work very well, second it makes sub-optimal use of limited resources and most importantly it harms economic development. However, I believe that the policy framework which I have outlined in this note can and should be interpreted as industrial policy as well. It might seem counter intuitive that attracting economic activity should not be at the centre of industrial policy. But maybe we can reinterpret industrial policy in such a sense that it allows spatial concentration of economic activities, builds infrastructure to connect rural areas to the economic centres (even encourages migration to the centres) and only targets specific problems rather than trying to direct the whole development process.