

# Chapter 7

## Urbanization and Rural-Urban Migration: Theory and Policy

### **Key Issues**

1. Urbanization trends and projections
2. The role of cities in the development process
3. the role of the informal sector
4. interaction between rural and urban sectors
5. The Todaro Migration Model
6. Policy options

## Trends in Urbanization: Some Stylized Facts

1. Positive relationship between per-capita income and urbanization (fig. 1)
2. The share of urban population has increased in both slow growing as well as rapidly growing countries (fig.2).
3. The share of urban population in developing countries is projected to increase rapidly (Table 7.1 Figure 7.4).
4. Some of the largest cities in the world are located in developing countries (Table 7.2, Figure 7.3).

The key question is how developing countries are coping with the rapid pace of urbanization – economically, environmentally, and politically.

A large section of urban population is deprived of even the basic amenities of water, sanitation, house, and access to health and educational facilities. A large proportion of urban population in developing countries live in slums (Table 7.3).

### **Factors Behind Rapid Urbanization**

1. Rural-Urban migration accounts for substantial proportion of growth in urban population (Table 7.4).
2. Urban bias in the development strategy is a major cause of rural-urban migration and the increasing proportion of slum dwellers.

# The Role of Cities: Agglomeration Economies

What explains the strong association between urbanization and economic development?

**Agglomeration Economies:** Benefits that firms, workers, and consumers obtain when locating near each other. These benefits arise due to economies of scale and network effects. These agglomeration economies are of two types: (i) **Urbanization Economies**; and (ii) **Localization Economies**

**Urbanization Economies:** It is easier to provide residential infrastructures, schools, health-care and other service activities, and consumer oriented activities. These benefits are general in nature.

# Localization Economies

**Localization Economies:** Benefits accruing to particular sector or particular type of firms from locating in the urban area. Clustering of firms may lower the cost of production ( due to bigger market, competing multiple suppliers, greater specialization and division of labor, lower transportation cost, access to specialized services etc.).

# Industrial Districts

**Industrial Districts:** Clustering of firms of same type. Localization economies encourage emergence of industrial districts. Clustering also has **spill-over benefits**:

1. Flexible Specialization: greater opportunity to contract out works
2. Learning: firms can more easily learn from each other regarding production processes, business practices, rules and regulations, business opportunities
3. Training and Technological Development: easier to develop training facilities; easier to develop, learn and adopt new technologies.
4. Social Capital: easier to resolve shared concerns through collective action.

## Efficient Urban Scale

Industrial districts are quite common in developing countries. These districts/cluster produce traditional goods such as handicraft as well as sophisticated goods such as compute software (e.g. Bangalore in India), surgical equipments (Sialkot, Pakistan). Some industrial districts are very vibrant and dynamic, but some are not. Whether an industrial district succeeds or not depends on other enabling factors such government rules and regulations, well functioning credit market, transport links etc.

### **Efficient Urban Scale**

There are also **diseconomies of agglomeration**. Additional competition drives down pricing power. Large cities attract problems of crowding and congestion. There is trade-off between these economies and diseconomies which determines the optimal city size..

# Hierarchy of Cities

Usually, in any country there are more than one cities. Some are big and some are small. What explains the emergence of cities of different sizes in a country? There are two theories: (i) **Urban Hierarchy Model (Central Place Theory)** and (ii) **Differentiated Plane Model.**

## Urban Hierarchy Model (Central Place Theory)

It is a geographical theory that seeks to explain the size and spacing of cities. Idea is that cities emerge to provide goods and services. Bigger cities provide higher order of goods and services (more durable, valuable and variable) as well as variety of goods and services compared to smaller cities, hence the term hierarchy. The theory relies on two concepts: **threshold** and **range**.

**Threshold** is the minimum market (population or income) needed to bring about the selling of a particular good or service.

**Range** is the maximum distance consumers are prepared to travel to acquire goods - at some point the cost or inconvenience will outweigh the need for the good.

## Urban Hierarchy Model (Central Place Theory)

Critical assumption is that different goods and services have different threshold and range. They depend on consumer preferences, economies of scale, transportation cost, and demand for land. The higher the order of the goods and services, the larger the range of the goods and services, the longer the distance people are willing to travel to acquire them. Examples of higher order goods are: big shopping malls, designer shops, specialized financial and government services. Examples for low order goods and services are: newspaper stalls, groceries, bakeries, and post offices. They are supported by a relatively smaller threshold population and demand.

## Urban Hierarchy Model (Central Place Theory)

The main prediction of the model is that goods and services with higher threshold and range are only located in big cities. Small cities only provide goods and services with lower threshold and range.

The Central Place Theory has been criticized for being static; it does not incorporate the temporal aspect in the development of central places. Furthermore, the theory holds up well when it comes to agricultural areas, but not industrial or postindustrial areas due to their diversified nature of various services etc.

# The Differentiated Plane Model

In this model transport cost plays a critical role. Idea here is that firms locate where the transport cost is minimum. This depends on the available transport links and the nature of industrial products in terms of inputs and output. Firms with strong forward and backward linkages tend to locate in the same city. Primary processing industries with few inputs tend to locate near the source of primary input. Places with favorable transport links (rail-heads, ports) attract firms.

# Urban Giantism

The previous model suggests that in a country with poor transportation network, there might emerge one or two big cities. Most of the firms and economic activities might be concentrated in one or two big cities. This may not be efficient from the social point of view. By diversifying the location of firms and economic activities one can reduce the cost of production and commuting as well as congestion.

Urban giantism may lead to **first-city bias**, in which the biggest city receives a disproportionate share of public investment, which aggravates the problem of urban giantism.

# Causes of Urban Giantism

1. Colonial legacy
2. Industrial policy of import-substitution and high tariff
3. Lack of democracy
4. Rent seeking behavior of public officials/politicians

## Urban Informal Sector

One striking feature of the urbanization in developing countries is the presence of a large informal (unorganized, unregulated, unregistered) sector. Between 30% to 70 % of urban labor force works in the informal sector (fig. 7.6). The main characteristics of the urban informal sector jobs are:

1. low skill
2. low productivity
3. self-employment
4. lack of complementary inputs particularly capital
5. small scale measured in terms of sales, assets, employment etc.
6. favored by recent migrants

## Role of Urban Informal Sector

One view of the urban informal sector is that it is a residual sector. According to this view, it is a reflection of limited industrial development. With industrialization and development this sector will disappear.

Another view envisages more positive role for urban informal sector in the development process. According to this view, this sector allows excess rural labor to escape from extreme rural poverty and underemployment. It is also a cheap source of inputs and services for the formal sector (backward linkage). Also by increasing the income of poor it increases the demand for goods and services produced by the formal sector. Over time the second view has gained popularity and the urban informal sector is now considered to be vital for reducing poverty and inequality of income.

## Advantages of Encouraging Urban Informal Sector

1. Informal sector has higher productivity than the rural sector and generates more surplus. These surplus can be utilized to promote the formal sector.
2. It has low capital-intensity. This sector is quite suitable for the factor endowment of developing countries (relatively scarce capital and abundant labor). It can create employment opportunities much faster.
3. It provides learning experience for both wage workers and self-employed and thus enhances human capital.
4. It generates demand for unskilled and semi-skilled workers which are again relatively more abundant in developing countries.
5. Since poor are concentrated in the informal sector, its promotion would ensure more equitable distribution of the benefits of development and faster reduction in poverty.

# Disadvantages of Encouraging Urban Informal Sector

1. Increased migration and aggravating the problem of urban giantism.
2. Increased urban unemployment.
3. Discrimination against formal sector bad in the long run.

## **Policies to Encourage Urban Informal Sector**

1. Remove policies which discourage informal sector.
2. Provide information and training facilities.
3. Increased access to capital and credit.

# Urban Unemployment

In most of the developing countries, urban unemployment has been very high (Table 7.7). Generally, it has been higher than the rural unemployment. Major reason for higher unemployment has been high level of rural-urban migration.

Rural-urban migration aggravates the structural imbalances in two ways. Firstly, migration increases the labor supply in the urban areas and depletes the human capital in rural areas. Secondly, job-creation in urban areas requires more resources relative to rural areas, reducing the resources available to rural areas.

The question is then what causes migration. Is migration good or bad? How does it affect development process, poverty, inequality and growth? What policies can be adopted so that migration has socially desirable outcomes?

## Harris-Todaro Model: Basic Characteristics

1. Migration is stimulated primarily by rational economic considerations of relative benefits and costs, mostly financial but also psychological.
2. The decision to migrate depends on expected rather than actual urban-rural real wage differential. Expected urban-rural real wage differential depends not only on the actual differential, but also on the probability to find jobs in the urban sector (fig 7.9).
3. The probability of obtaining an urban job is directly related to the urban employment rate and inversely related to the urban unemployment rate.
4. Migration rates in excess of urban job opportunity growth rates are not only possible but also rational.

## Policy Implications

1. Urban bias in the development policy aggravates the urban unemployment problem.
2. Faster job-creation in the urban areas is insufficient solution to the urban unemployment problem.
3. Indiscriminate educational expansion leads to further migration and unemployment.
4. Providing wage subsidy in the urban area may increase urban unemployment.
5. Programs of integrated rural development should be encouraged.

# Elements of Comprehensive Migration and Employment Strategy

1. Creating an appropriate rural-urban economic balance.
2. Expansion of small-scale, labor-intensive industries.
3. Eliminating factor-price distortions.
4. Choosing appropriate labor-intensive technologies of production.
5. Modifying the linkage between education and employment.
6. Reducing population growth.
7. Decentralizing authority to cities and neighborhoods.