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URBANIZATION, THE RURAL SECTOR, AND SOCIOECONOMIC TRANSITION IN  
DEVELOPING AREAS

October 16, 2008 – 2:00 – 2:30

*Speaker:* Robert Hormats

**Ambassador Kenneth Quinn**

President - World Food Prize Foundation

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If I could ask everyone to take your seats, so we can begin the afternoon program.

And we are extremely privileged to have with us to open the afternoon session someone that I have known for now well over 30 years. And I think he's one of the most brilliant economists and international development experts, Bob Hormats.

Bob is now the vice chairman of Goldman Sachs. He's been with the company since 1987 and was vice president of international corporate finance before that. And I met him in the mid-1970s when I came to work at the White House on the National Security Council staff. And he was down the hall from me, and I used to go in and visit with him about all of the issues on the economic front. And being a political scientist, it didn't take too long for him to explain things to me and then run out of what I could understand.

But I recognized then that he was somebody who was going to have a meteoric rise. And he was assistant secretary of state, deputy U.S. trade representative, and now in his position on Wall Street.

Bob, you can't see this, but I'm holding up a copy of your most recent book, *The Price of Liberty*, which I'm telling everybody about and encouraging them to go out and buy copies. We're sorry that you weren't able to be with us here in Iowa. And it's still my hope that you can come and I can show you my home state. But thank you very much for being with us via this video link. And the floor is yours.

**Robert Hormats**

Vice Chair, Goldman Sachs

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Well, thank you very much. We had some great times together in the White House on the NSC staff years ago. And I'm very proud to say that we've kept our friendship for a lot of these many years. And the job you're doing and that everyone over there is doing in helping to focus on the international food problem, I think, is really extremely important.

And I will make this point later in my remarks, but even though we're in the middle of a major financial crisis here in other parts of the world, it's particularly important that we not forget about the problem of food – even though food prices have come down, and perhaps in some areas the crisis has been ameliorated a bit, it's still a major and pressing global issue.

And it's therefore a particular honor for me to have a chance to talk to this very distinguished and very dedicated group about the topic that you've assigned to me, which is to talk about the impact of urbanization on the rural sector. And in particular in doing that, I'm going to focus on an area that I know reasonably well, because during my years at graduate school I spent a good deal of time in the rural parts of eastern and southern Africa and therefore have a particular sense of the importance of addressing the problems of sub-Saharan Africa, and therefore I'm going to talk a little bit more about that as we move through my presentation.

I think it's useful to note that, for the first time in history, half of the world's population now lives in cities. And these cities require vast amounts of infrastructure to sustain themselves – roads, railways, airports, housing, water, sanitation facilities, and a variety of elements of infrastructure. And all this is likely to increase pressure on commodities of various sorts, particularly because the food demands of people in urban areas tend to grow relatively rapidly. They're not in the producing business, they're in the consuming business.

And as they move up the ladder in terms of their incomes, obviously the more food they consume, different kinds of food as well. And that, of course, as I'm sure you've discussed, has a major impact on the rural sector and the kind of demands that are made on the rural sector.

One of the areas that I have focused on in particular is the BRICs – Brazil, Russia, India, and China. They are going to be the home to five of the world's 10 largest cities in the year 2015. Mumbai, for instance, will be seven times larger in 2015 than it was in 1950, Delhi 13 times larger. And by 2015, the world's going to have 22 mega-cities, all of which will be consuming larger and larger amounts of food and other raw materials as well.

I think it's useful in looking at this to note that there are enormous rural-urban income divides in many emerging economies. Urban incomes are forecast to rise, and have been rising significantly over the last several years. Cities like Shanghai, Mumbai, Beijing, Sao Paulo, and others have achieved very rapid rates of growth and large increases in incomes and in living standards.

But these urban areas also not only concentrate wealth but they also concentrate poverty. Poor people in those cities tend to be confined to slums and are largely segregated from much of the rest of the population.

And infrastructure, which I've been asked to talk about, is really the key differentiating factor between parts of the urban areas of developing and emerging economies and rural sectors. The urban-rural gap in access to water and sanitation, for instance, is in many of these countries quite large. It's particularly pronounced in some relatively large countries. You see it in Brazil, you see it in China, you see it in most other emerging and developing nations as well.

But in the poorer parts of urban developing countries, infrastructure is also lacking. Infrastructure tends to be beneficial to the wealthy areas, but it's really not as highly developed in the slum areas. In many cases they do not have access to water, do not have access to sewage. And one

of the keys to addressing the issue of urban poverty is to deal with questions of water and sewage – very basic services that many of us tend to take for granted simply aren't there either. So in many cases they have a lot in common with the rural sectors in these countries, and that is that the infrastructure there also needs to be built out.

Because urbanization and industrialization will continue to absorb agricultural land and labor in many countries, it puts an added demand on the rural sector, and it will mean that there's going to be a lot of pressure to increase yields in the rural parts of the developing and emerging economies. This may, in fact, increase productivity growth, but it could also exacerbate environmental degradation and further strain water supplies.

Agriculture accounts, as all of you doubtless know, for the vast majority of freshwater withdrawal from the ground in almost every major emerging economy in the world. But even so, today in the large emerging economies, only around one-third of the cropland in these countries is irrigated, which suggests that agriculture's draw on water resources will intensify and intensify quite dramatically over coming years as demand for food increases and demand for yield increases.

Developing and urbanizing countries therefore face a dual challenge of supporting intensive agriculture to meet the growing demands of the cities and other parts of their countries, while also preserving freshwater supplies.

Worldwide, 70 percent of total freshwater withdrawal goes to agriculture, and therefore efficiency in the use of water is critical to improving agricultural yields. But it's also important to preserve the supplies of freshwater for other purposes as well.

Many nations in the water-short Middle East, including Israel and the UAE, are experimenting and have made major breakthroughs with new technologies in the area of efficient utilization of water that could be valuable to other nations of the world as well. And many of them already have cooperative programs in other parts of the world to help transfer some of this technology and know-how to them.

The FAO estimates that irrigated crop production will need to increase by about 80 percent between now and 2030 in order to match demand. At the same time, it expects irrigated-land water use to rise by just 12 percent, thus increasing the demand for the efficiency in the use of water and of fertilizer to get more out of individual cropland and make sure that there is an efficient use of all the inputs that go into agricultural production.

The critical use of fertilizer is obvious when you look at the numbers. If you take a look at, for instance, China and India, China uses almost three times as much fertilizer per hectare as India does. And while this boosts agricultural yields quite substantially and does help to support China's massive and rapid urbanization, it also raises issues that the Chinese government is dealing with, and that is the risks of water pollution to both countryside and urban areas.

And this sort of sets the stage for what I want to talk about for the rest of my presentation. And that is the importance of paying at least as much, in fact more, attention to the plight of the low-income, food-deficit countries. Even though the price of food is going down and the availability is a little bit greater than it was a few months ago, we shouldn't lose sight of the fact that food is still a big problem.

And doubtless you've been focusing on that and will continue to focus on that because it's so important for so many people, particularly people at subsistence levels of farming, and therefore helping the world's poorest nations. And even the poorest groups within relatively well-to-do nations must continue to receive a substantial amount of focus by the international community.

The High-Level Conference on World Food Security underscored the importance of helping farmers, particularly small-scale producers, to increase production and integrate with local, regional, and international markets, as well as to help them to have access to locally adapted seeds and fertilizers, animal feeds, and other inputs, as well as the technical assistance needed to boost agricultural production.

Let me focus in particular on Africa for a moment, because it's the area that, as I mentioned, I have had some exposure to in the past, particularly in eastern and southern Africa.

Roughly two-thirds of the farmland south of the Sahara is plagued by soil degradation, some of it clearly very serious. Fertilizer use has been growing by about 1.5 percent per year, excluding South Africa, where it's been higher. But it remains very low by international standards.

Africa's roughly 500 million subsistence farmers account for less than 2 percent of global fertilizer use, and average farm yields tend to be very low. And soils in much of the region are highly acidic; that tends to force farmers to clear new plots after only a few plantings seasons. And more than 90 percent of the agriculture in the region is dependent on rainfall; it doesn't have a structured irrigation system.

And therefore there is – while one could look at this in a pessimistic way, there are also some opportunities, and those are the ones I want to focus on. There is scope for significant increases in agricultural production if new farmland is opened up and the land already available is better-managed.

Many African countries use less than 20 percent of their potentially arable land. In some cases this is related to poor or erratic rainfall and could be dealt with with better irrigation, more efficient use of the irrigation that is available. And that requires a lot of infrastructure spending, at least initially. In some cases the problem is that that land might be good land but simply isn't connected by a system of feeder roads or other roads to potential markets in urban areas or elsewhere. And this is a problem in many parts of the developing world.

But there are some interesting new opportunities. Since the early part of the 1980s, the world has seen a dramatic use in food for biofuels, and that of course has taken off dramatically as the price of oil went up in the early part of this decade. And that use of food products, potential food products, has gone up dramatically, even more rapidly than food for direct consumption and food as feed grains for animals. The energy part has seen a very rapid rise.

Rising world demand for biofuels offers farmers in various parts of Africa a substantial amount of opportunity to raise their incomes by raising a new cash crop. There are obviously fears that biofuel production could crowd out food production, but in Africa it's a little bit different, at least in some parts of Africa, because there's a lot of potentially productive arable land that could be devoted to some of these cash crops, not to the exclusion of food production.

And there are some biofuel feedstocks, such as jatropha, that can be grown on land that is very marginal where a lot of food products might not be able to be grown. So looking for types of potential biofuel products that can be grown on marginal land that don't compete with the food-chain production can be a very useful part of expanding cash crops in Africa.

One other interesting new twist is that there is a growing interest among capital-surplus, food-deficit countries in investing in Africa and other parts of the developing world. For instance, the UAE and Saudi Arabia are seeking investment opportunities in countries in Africa such as Sudan and also other countries that have the capability of increasing food production, such as Pakistan.

And if managed constructively and correctly, these investments in underutilized land can be of great benefit to the host nation as well as to the country that makes the investment. It can create jobs; it can improve infrastructure because, when investment takes place, it can also be supported by complementary infrastructure and new technologies that can make agriculture more efficient.

So in many parts of the world, foreign investment, or overseas investment in agriculture, really has not been a major factor. And yet now with a hungrier and hungrier world with a lot of urbanization, and a lot of countries that have capital and are working to diversify their investments around the world, the potential for overseas investment in agriculture in emerging economies, both in agriculture for food and perhaps agriculture for energy as well, could be useful. It has to be managed properly, obviously – it's not a panacea, but it is a new dimension, a new twist that can potentially be useful.

The UAE, for instance – I'll cite them again because they've been very innovative in this area – is also working with the FAO to establish a research facility to enhance crop yields in the Gulf states and other parts of the world. And the U.N. is supporting the notion of increasing private as well as public investment in agriculture, in some cases to improve rural infrastructure and in so doing allowing small farmers to benefit more from increased market opportunities.

It's worth noting here that countries that have pursued bold policies in these areas have obtained remarkable results. One country – there are a number I could mention – one country I'm particularly familiar with is Malawi. And it has taken, after a very severe drought in 2005, some very significant measures, particularly to subsidize fertilizer use.

Now, this is very controversial. There's some who will argue, "Well, there's a high-opportunity cost in putting money into fertilizer" – as opposed to technical assistance, as opposed to doing research and feeder roads and such things. But it's had a pretty remarkable impact on developments in Malawi. And now they've had bumper crops and have been able not only to feed the people of Malawi but also to sell product to Zimbabwe and Swaziland and other areas in the region.

And it's only one experiment among others, but it's proved to be relatively successful, and I've had opportunities to talk to the president of the country about what he's doing and how he's done it and how important it's been in improving and turning around the economy. Expensive, yes, but it dealt with the problem that the country had, a very serious one, only a few years ago.

Since I'm running out of time, let me try to conclude and make a few just summary points that pull together some of these thoughts.

First: The financial crisis that we're now experiencing and the recent drop in food prices may divert some attention away from the area of food. But it seems to me that we should keep our eye on this as a long-term developmental problem and as part of a structural problem that is occurring with more urbanization and therefore more demands on the rural sector to provide more food and high-quality food to what's happening in the urban areas and the rapid rate in growth and demand in some of the wealthier emerging economies as well as the larger, industrialized economies.

This is a structural shift, and it tends to push prices of food and products and fertilizer up. They've come down a considerable amount, but the structural shift that underlies those factors is still with us. And after this crisis is over, we're probably going to see stronger growth in these emerging economies again. When that will be, hard to predict, but it will happen at some point, and we ought to be aware of it and its impact on food prices and fertilizer prices but also potentially see it as an opportunity for some of the poorer countries of the world to take advantage of this opportunity as opposed to being disrupted by it, which has been the case for many of them over the last several months before prices started going down.

Second point is: Many of the problems of the past result from insufficient investment in some key parts of the food production and delivery chain, including irrigation facilities, fertilizer, roads, etc. So there are real supply-side constraints that have to be overcome in dealing with this problem. And some of that investment, a large portion, should go into some of the very poorer countries or poor parts of the wealthier, emerging economies.

Third: Urbanization will place additional demands on food production throughout the world. And that, plus the biofuels boom, can actually take land out of production in the food chain. But if we do this the right way and we're creative about it, there can be enormous benefits for the reasons I've mentioned earlier, which is that if people invest, if there's more investment, particularly in marginal lands in biofuels, potential biofuels, that can be an additional cash crop. And just by putting more investment in, you can also get technological assistance into these countries and get more investment in infrastructure as well.

So I think that during this period – when we're focusing on a lot of other issues, dealing with some of these infrastructure issues, dealing with the water issue, dealing with the fertilizer issue, and seeing where, particularly in Africa, you can find ways of helping bring marginal land into the production process, into the production chain, and find ways of providing the water and the fertilizer and the infrastructure – using obviously domestic tools but also attracting foreign investment could provide some enormous opportunities during this period if we're very creative about it.

So let me stop there and see if there are any questions. I can't see you, but if there are any, you can shout out and I'll try to answer them.

## QUESTION AND ANSWER SESSION

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**Quinn** Sure. We do have time for a few questions, and I want to invite people to the microphones. Just want to say thank you for this wonderful overview and look at these issues. And you've identified many of the key factors that we're talking about here today.

The only point I'd make to the audience is – When you serve at the National Security Council, very often the new special advisor to the President will come and the whole staff will be changed, or there's a change of administration or change of parties, the staff gets changed. And when that happened, I got sent back to the State Department. But Bob was there with Henry Kissinger and with Brent Scowcroft and with Zbig Brzezinski. And now having seen him speak for a half hour, you all can understand why. Thank you very much.

**Hormats** Thank you, Ken, thank you.

**Quinn** You're welcome. That was terrific.

**Hormats** thank you.

**Quinn** So here's the first question for you.

**Hormats** Thanks.

**Quinn** Please identify yourself.

**Question** Nsisuk Ekanem is my name; I am a process engineer and green technologist. I want to comment on the potential threat of urbanization in developing countries. I live in a rural area, and I face a real challenge there. What is the consequence? The consequence is this: we have elderly people in the rural setting. Their children are all in the urban centers, leaving a very low-level force in the rural areas. And I have thought of, if we can have food banks and food reserves, why can't we create economic opportunities in rural areas and call it "food nest," a place where agricultural opportunities can be created at the rural centers, attracting global funding and participation? Like our president rightly said, that this is a place where ideas could be crystallized and then pushed onto the international community.

We have free-trade zones, and now we have many free-trade zones in different parts of the world. Why can't we have a food nest where a kind of condition that exists in the free-trade zones for trading can exist, but this time we don't trade but we engage in agricultural activities.

**Quinn** So the question is creating food opportunities for work in rural areas and towns.

**Question** Rural areas, yes.

**Hormats** Food opportunities. Trading within rural areas, you're talking about.

**Question** Yes.

**Hormats** I think that's a very important point. Which country are you from?

**Question** From Nigeria.

**Hormats** Nigeria. I think you've raised a very interesting point. Even by expanding networks within a region, you can create greater demand. Part of the problem – and if I understood the question correctly – is that producers in rural areas, particularly, find it very difficult to have trading opportunities with urban parts of their country and other rural parts of their country.

And I found this when I was in rural Tanzania in the upper, what they called Musoma District, which is in the northwestern part of Tanzania. There were a lot of very productive farmers because it was right on Lake Victoria; there was a fair amount of irrigation. But the roads were not good enough, and there was not sufficient storage capability. And also they weren't familiar with market conditions even 50 or 60 miles away where people could have been potential buyers of their products.

So I think what you've talked about is very interesting, and it means, first of all, infrastructure with a better road structure. Second, it means a lot more information about needs and requirements. And third, I think it means opportunities for providing them with the ability to get food to market.

**Quinn** Well, thank you very, very much, Bob. This has been a terrific segment. You've gotten us started in the afternoon. Bob Zoellick is going to be on later, a colleague of ours –

**Hormats** Yes.

**Quinn** – on the program. And in between we have a terrific panel of business executives and senior representatives of NGOs kind of all together looking out over the next fifty years.

**Hormats** Well, it's been a privilege to be with you. And as I say, I think while we're in a period of crisis now, they are real opportunities because of growing need for food and, therefore, for countries that are able to supply it with proper amounts of new inputs and better infrastructure and new capital. There is more interest, I think, than ever, or should be, in providing the technology and the capital and the infrastructure to feed the demands of urbanizing parts of the world and to deal with some of these energy issues in a way that doesn't compromise the food chain.

So I think there are enormous, creative opportunities here, and I'm privileged to be able to talk to you about them. Anything I can do to be helpful, please let me know. Thank you.

**Quinn** Well, no. Thank you. And just as a personal comment, as watching the crisis there unfold on Wall Street and in the financial markets, one of the things that makes me sleep a little better at night is knowing that you're there and people like you are there working on this. So thank you, again, Bob so much.

**Hormats** Thank you, all. Have a great day, great to be with you. Thanks.