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Toward the Rural-Based Development of Commerce and Industry: Selected Experiences from East Asia, Y. Hayami (Ed.), World Bank, EDI Learning Resource Series, Washington, DC, 1998, US\$ 30.00, 312 pp., ISBN 0-8213-4026-3.

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Toward the Rural-Based Development of Commerce and Industry: Selected Experiences from East Asia, edited by Prof. Yujiro Hayami, is a timely and highly valuable contribution to the subject of rural industrialization – the principal non-farm rural economic activity interlinked with agriculture, rural services, and trade. This is a subject of great interest to the developing countries in general, both in Asia and elsewhere, as they face the challenge of providing employment for an expanding labor force, given the slow growth in labor absorption or employment in agriculture, on the one hand, and in the large-scale industries centered on large metropolitan cities, on the other.

Six case studies, historical as well as relatively recent, related to rice marketing, cotton weaving, and automobile industry in Japan (Toyota), and garment industries in Thailand, Philippines, and China. There is a chapter comparing the organizational characteristics of rural textile industries in the above countries. Two chapters compare the overall experience of Korea and Taiwan in respect to the rural industrialization including an analysis of both political and administrative structures, and government policies relating to rural industrialization.

Very lucid and comprehensive summaries and analyses of the factors contributing to or facilitating relational contracting in various countries covered in the study are provided in the introductory chapter by Professor Yujiro Hayami. The lessons derived from their historical experiences as well as comparable exercises in rural trade and credit with smallholders are contained in the last chapter by Dr. V.V. Bhatt.

The main thrust of the analysis is that for the successful development of the type of rural trade and industry that is often carried out in small and scattered enterprises, it is essential to develop a mechanism through which the latter would be effectively linked with large urban and foreign sources of demand. The case studies elaborate the nature of linkages between small, rural-based manufacturers, on the one hand, and traders or agents of large, urban-based firms (including the rural-based manufacturers and their works), on the other. These linkages, called ‘relational contracting,’ played a critical role in the growth of East Asian rural trade and industry.

The characteristics of ‘relational contracting’ between rural enterprises (trade and industry) and urban enterprises (their agents) seemed to be the following:

1. Long-term contractual relationships between the urban principals (enterprises or traders in urban areas) and rural agents (rural workers or small-scale enterprises) were based on economic ties, but also were strengthened by socioeconomic links and community norms or traditions. The community relationships involved an exchange of personal favors and obligations, following patron–client relationships so prevalent in a traditional community. Close physical proximity as well as social and cultural ties strengthened the contractual relationship. Similarly, the management of workers by rural entrepreneurs was partly based on personal contact and knowledge. The rural entrepreneurs often provided various personal favors to the workers.
2. There was frequently interlocking of contracts that involved one or several of the following: a contract for provision of materials and/or credit – as in the putting out system; guaranteed purchases of finished good; and interlinked purchases of finished goods with technical assistance and credit – as in the advance order system.

The mutual trust and experience generated by both (1) and (2) ensured that the transaction costs of enforcing contracts were reduced, thus minimizing moral hazards and the need for legal recourse for the enforcement of contracts. This was because the subcontract included not only the transaction of economic goods and services, but also the exchange of personal favors and obligations. The risk of opportunistic behavior was further minimized if the principal and the agents chose their partners after repeated transactions that provided each party enough information to make an informed choice.

Relational contracting is a substitute for vertical integration in large-scale industries; it is more cost effective and flexible. The types of relational contracting differed among countries as well as among different types of industries. Even though the study, in general, emphasizes the role of community and personal links in the system of contracting, in some cases, social element was not very important; in fact, economic factors were dominant. The economic factors that facilitated subcontracting were technology and commodity characteristics such as divisibility of production processes and dualism in factor markets, etc.

The subcontracting system provided for economies of specialization/division of labor as well as economies of agglomeration; it facilitated the adaptation of production mix to changes in demand.

The examples of relational contracting provided in the study, such as the Toyota (automobile factory) in Japan, the bicycle and tractor industries in India and the garment industries in various countries demonstrated that they were a very wide range of industries to which the system could be efficiently applied. Traditionally, it was often thought of as particularly relevant to the weaving–garment–textile industries, probably in view of the relative ease of splitting production processes into different degrees of factor intensity. However, it was subsequently demonstrated that a wide range of industrial production processes could be split up into components of varying degrees of complexity and labor intensity, so that small-scale rural enterprises could use more labor-intensive and less skill-intensive methods. In many cases, subcontractors were provided adequate technical assistance and training to meet quality requirements.

Large-scale enterprises often helped in the establishment of small family workshops for production of parts and components. The Toyota factory in Japan wanted suppliers/manufacturers of parts to be located in its vicinity and tied together in a common community spirit so that the suppliers would have a close personal contract with the Toyota factory. In Punjab, India, the bicycle industry encouraged their workers to set up separate enterprises of their own to produce components. In the latter case, the principal and agents (subcontractors) came from the same community; community spirit was enhanced by the family, social, and cultural ties. Yet another example was that of a tractor factory in Punjab that subcontracted the production of components while assisting them with technical advice, design of components, and training. These activities were oriented towards fostering close personal ties. It cut down capital investments and upgraded its R&D adequately to design components that could be produced by subcontractors.

In the case of garment factories in Thailand, Philippines, and India, components of relational contracting were not uniform. Community or social links were not important in garment industry in Philippines, but they were of some importance in India (subcontractors lived in close proximity to the principals) and in

Thailand, where the rural entrepreneurs were not only known to the principals but also were trained by them in their large urban enterprises. In some cases, workers in urban industries graduated into entrepreneurs by starting rural enterprises on their own; in others the traders engaged in selling the products of large industries eventually became small-scale producers of their parts or components. In other cases, repair shops grew to be subcontractors producing components or parts. In all these cases, the subcontractors had previous experience of dealing with or personally knowing the contractors in different capacities over a period of time.

Where did the rural entrepreneurs emerge from? As the foregoing examples indicate, the farmers, traders, artisans, and landless laborers, in many cases, provided the sources for the growth of the rural entrepreneurship. Frequently, medium or large farmers branched out into rural enterprises largely linked to agriculture, trading inputs or outputs, or manufacturing inputs or processing outputs. Rural traders, as market expanded, started manufacturing enterprises or started trading with urban areas. Landless labor initially found employment in all kinds of rural enterprises; over time as they improved their skills and they started rural enterprises on their own.

There are a few aspects of the process of development of rural trade and industry that are not adequately emphasized in this study. First, most of the rural enterprises discussed in the study were not located in villages; they were located in small towns. Enterprises located in villages did not, in general, have subcontracting relationships with urban enterprises. It was the small-town enterprises that were linked to the urban enterprises. The household industries or village enterprises based predominantly on family labor produced outputs that were used or consumed within the villages.

Second, the stimulus to the growth of the rural trade and industry was not only provided by the possibility of subcontracting with urban enterprises, but also they developed to a very large extent in response to the expanding market provided by rapid growth in agriculture. As agriculture and farmers' income expanded, rural enterprises grew up in the villages as well as in the rural towns, not only to meet increased rural

consumer demand, but also to produce intermediate inputs for agriculture or to process its output. These farm/nonfarm linkages have been extensively discussed in the literature. The study under review concentrates only one aspect, that is, linkage of rural industry/trade in the small towns with the urban industry/trade, including urban industries specialized in exports. Undoubtedly, this linkage greatly expanded the market for the rural industry and facilitated transfer of technology, and in some cases capital, to the rural entrepreneurs.

Third, the role of infrastructure, transport, and communications was critical for the development of rural trade and industry. They provided not only effective linkages with urban industry, but also for facilitated trade and transactions among villages, between villages and small towns and among small towns.

Fourth, decentralization of administrative and political decision making was helpful to the development of rural industry. Under a highly centralized system, macro or sectoral policies tended to be centered around metropolitan areas; the needs and possibilities of rural areas or small towns distant from the center of government tended to be neglected. The highly centralized system of both political and economic control in Korea did not encourage the growth of local, rural-based entrepreneurs to an extent comparable with Taiwan with its highly decentralized political and economic decision-making process.

In spite of recent financial turmoil in the East Asian countries, their long-term development experience continues to hold many valuable lessons for other developing countries. One of the lessons was the significant role played by small rural industries in close integration with large-scale urban-based industry, on the one hand, and agriculture, on the other. This collection of essays on the rural commerce and industry in the East Asian countries makes a very significant contributions towards interpreting this experience and analyzing both economic and social factors responsible for such a phenomenon. Development economists everywhere concerned with rural development policies will find this book highly rewarding and useful.

