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# Making Markets Work for the Rural Poor: A Symposium

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## Introduction to a Special Issue on Making Markets Work for the Rural Poor

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The Bible clearly directs believers to care for the poor. But with an estimated 1.3 billion people living in "destitution" (below $1 a day), another 1.6 billion in "extreme poverty" (above $1 a day but below $2 dollar a day), and 2.5 billion more in "global poverty" (more than $2 a day but less than $10 a day),[1] the scope of the task appears daunting. It often seems that the poor will indeed always be with us (Deut. 15:11, Matt. 26:11, Mark 14:7, John 12:8). Surely no individual, no government, no congregation can feasibly care for all these poor people. So if we are to heed the biblical call to aid the poor, other mechanisms are necessary.

This is where economists often invoke Adam Smith and the capacity of decentralized markets to advance social objectives. Markets can be a powerful force for good. By aggregating demand and supply across actors at different spatial and temporal scales, well-functioning markets underpin important opportunities at the micro level for welfare improvements that aggregate into sustainable macro-level growth. For example, without good

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access to distant markets that can absorb excess local supply, the adoption of more productive technologies typically leads to a drop in product prices, erasing all or many of the gains to producers from technological change and thereby dampening incentives to adopt new technologies that can stimulate economic growth. Markets also play a fundamental role in managing risk associated with demand and supply shocks by facilitating adjustment in net export flows across space and in storage over time, thereby reducing the price variability faced by consumers and producers. Markets can also induce socially beneficial innovation to relieve binding factor constraints on production. Markets thus perform multiple valuable functions: distribution of inputs and outputs across space and time, transformation of raw commodities into value-added products, transmission of information and risk, and inducement of desirable innovation. Per the first welfare theorem, competitive market equilibria help ensure an efficient allocation of resources so as to maximize aggregate welfare.

Yet a vast literature chronicles the many ways in which the poor can be systematically excluded from or disadvantaged by market exchange when information asymmetries, transactions costs, risk, insecure property rights, or other regular sources of market imperfections disturb the appealing fiction of a first-best world. The beneficent power of markets too often appears to bypass the poor, perhaps especially in rural areas where more than three-quarters of the world's extreme poor live, and market failures loom especially large (World Bank 2007).

Such failures often motivate government intervention in markets, although interventions have often done more harm than good, either by distorting incentives or by creating public sector market power. Indeed, the history of rural markets in developing countries reflects evolving thinking on the appropriate role for government in trying to address the inefficiencies created by incomplete institutional and physical infrastructure and imperfect competition. The emphasis in the 1960s and 1970s on government intervention to resolve market failures gave way in the 1980s to market-oriented liberalization to "get prices right" and, more recently, to a focus on "getting institutions right." Of particular interest to the contributing authors to this special issue, recent years have brought substantial growth in interest around the question of how to make markets work more effectively for the rural poor. Indeed, many low-income nations' Poverty Reduction Strategy Papers and associated economic development strategies have placed high priority on stimulating increased market participation among the rural poor, and church-based and secular non-governmental organizations (NGOs) around the world have vigorously taken up this challenge.

This special issue originates with a three-week Seminar in Christian Scholarship that Calvin College graciously hosted in July 2005 on the topic "Making Markets Work for the Rural Poor: Christian Mission and Global Enterprise." This seminar involved fourteen participants from ten different colleges and universities and two non-academic research institutions in the United States and Europe, as well as a visiting speaker from the Rockefeller Foundation. It was an exceptionally talented group with a wealth of energy, experience, and skills. This made for rich interactions within the group, drawing on practical as well as technical expertise, a range of spiritual traditions, and a variety of domestic and international experiences. The seminar not only fostered networking and fellowship among Christian development economists, it also sparked original research, including new collaborations such as those reflected in the Boughton et al. and Wilson and Stapleford contributions to this special issue. We organized an Association of Christian Economists session at the January 2007 meetings in Chicago based on a selection of papers submitted for this special issue. Following rigorous peer review, we now introduce this set of four papers.

### Smallholder Market Participation and Rapidly Evolving Value Chains

The first step in answering the question of how to make markets work for the rural poor involves establishing clearly their patterns of participation in markets. The Williams and Okike (hereafter W&O) and Boughton et al. papers explore this issue in detail using micro-level survey data, W&O with respect to livestock producers and traders operating in the borderlands of Burkina Faso, Côte d'Ivoire, Ghana, and Mali in interior Sahelian west Africa, and Boughton et al. concerning farm households growing cotton, maize, or tobacco in rural Mozambique. These authors find that institutional and physical infrastructure markets as well as the social underpinnings of market lead to differential access to and outcomes for producers and traders of different size and initial wealth. The data hint at locally increasing returns to more remunerative forms of market participation that can impede the poor's access to better market opportunities and foster growing inequality. Even where markets appear to transmit information well across space and time through price signals, many smaller-scale producers remain incapable of taking up market-based opportunities due to familiar problems of access to capital, infrastructural obstacles, etc.

Ruben and van Eyk (hereafter R&vE) echo this message in their description of the dynamics of global fruit and vegetable value chains. They argue that, as these distribution channels have focused more on product quality and food safety attributes and less on price as the determining factor in procurement decisions, that a premium has emerged to supply chain coordination and has induced many downstream wholesalers and retailers to drop smaller-scale producers unless specific governance arrangements are in place to enable smallholders to function as if they were larger suppliers. Like Boughton et al., they find that in markets characterized by more complex contracts involving quality control and therefore requiring skilled labor and other valuable private inputs, poorer households are falling behind. They document this at the aggregate level of developing countries' market shares in fruit and vegetable exports, which declined over the course of the 1990s, as well as at more disaggregated levels of farmer groups and individual growers.

A root explanation of these patterns appears to lie in market structure. W&O describe livestock marketing channels in west Africa where mobility barriers sharply constrain enterprise growth and only the better capitalized traders are able to enter the higher-return, higher-cost long-haul, cross-border market (Caves and Porter 1980, Barrett 1997). R&vE similarly report how the complex web of interlinked contracts that increasingly characterize cross-border fresh fruit and vegetable trade have generated intra- and inter-firm coordination mechanisms that effectively crowd out many small growers and producers groups.

This is a new variant on an old theme. For decades, the higher value major export and domestic staple food crops were heavily regulated by state-run marketing boards, leaving only smaller-scale and lower-value food commodities for domestic consumption to operate on a truly free market basis, with little price regulation and few barriers to entry or exit. These markets are characterized by many cash, spot market transfers of product between intermediaries en route from producer to consumer, many small, non-specialized and unorganized buyers and sellers, few if any grades or standards, one-on-one (dyadic) price negotiations, poor market information systems, and mostly informal contracts, largely enforced through social networks (Fafchamps 2004). Such marketing channels depend disproportionately on rural periodic markets prevalent in most of the developing world, arguably the closest one ever gets to a true "free market": free of government regulation, subsidies and taxes, and lacking public goods such as physical infrastructure, contract law, public market price information systems, or codified product grades and standards. Indeed, they have been termed the "flea market economy" by Fafchamps and Minten (2001). The livestock markets W&O describe in west Africa fit this description reasonably well as do the low-value, bulk commodity maize markets that Boughton et al. study.

State control of the higher value-added agricultural markets largely ended with market-oriented agricultural policy reforms and economic liberalization in developing countries in the 1980s and 1990s. The new focus was on re-establishing a close correspondence between local and world market prices, so-called border parity pricing. The withdrawal of the state from agricultural market intermediation, specifically price discovery, was seen as a necessary condition in getting prices right, itself a necessary condition for improving market efficiency and stimulating investment and productivity growth (Timmer 1986). The net result of these reforms typically turned on the balance between the pro-competitive effects of reduced government interference in marketing operations—what Lipton (1993) termed "market relaxation"—and the anti-competitive effects of reduction of public goods and services that underpin private market transactions—what Lipton (1993) termed "state compression." Since the two phenomena were typically inextricable in agricultural liberalization initiatives, experiences varied markedly.

The empirical evidence suggests that commodity prices generally increased after market reforms, often stimulating an increase in production, especially of export crops. These price increases also facilitated the emergence of supermarket chains, export-oriented outgrower schemes and export processing zones, and a generalized stimulus to agro-industrialization in developing countries (Reardon and Barrett 2000). Increased investment in the downstream marketing channel has transformed the orientation of many agricultural markets from raw commodity towards processed product markets, and with this increased investment came increased competition. In middle-income countries such as Chile, India, and South Africa, private firms now play a leading role in development of improved seed varieties, producing and distributing inputs, post-harvest processing, and modern retailing through supermarkets and restaurant chains, and that influence is rapidly spreading to lower-income countries (Reardon et al. 2003, Reardon and Timmer 2007). Both formal and informal traders entered agricultural commodity marketing channels as government controls fell away, from rural periodic markets all the way through urban retail markets.

However, market entry has tended to be limited to certain marketing niches not protected by capital, information, or relationship barriers, with substantial bottlenecks in other areas such as inter-seasonal storage and motorized transportation, as W&O document. Neither widespread entry into market intermediation activities nor workably competitive markets emerged everywhere, let alone quickly. For example, because long-haul motorized transportation in rural markets tends to involve considerable sunk costs and some economies of scale due to poor road conditions and high vehicle maintenance costs, entry into this sector of the markets has often been limited after the removal of legal and policy barriers to entry (Barrett 1997). Meanwhile, the end of pan-seasonal and pan-territorial administrative pricing has brought increased price risk, with consequences for investment incentives facing both producers and market intermediaries (Barrett and Carter 1999).

The elimination of input subsidies and removal of government monopsony power in crop marketing has also often led to reduced access to input financing and increased input prices. The withdrawal of parastatals from core input marketing activities created a void that the private sector often failed to fill due to underdeveloped physical communications, power and transport infrastructure, credit constraints, and continued bureaucratic impediments that increased transactions costs for input suppliers. In addition, periodic state and donor-funded input programs have often reduced profitability and frustrated private investments. Input credit schemes by processors have sometimes been used in the post-reform period in an attempt to overcome the low input use resulting from these access problems.

As the weaknesses of reformed agricultural markets in developing countries became evident, development agencies' and governments' focus began to shift from merely "getting prices right" to "getting institutions right" so as to address market failures arising from imperfect information, contract enforcement, and property rights, and insufficient provision of public goods. Such reforms have used non-price measures in an attempt to develop the public and private institutions necessary for efficient market operations and to reduce transactions costs and business risk.

The post-structural adjustment era has also coincided with international market deregulation through the GATT and its successor, the WTO. Bilateral, regional, and global trade agreements have reduced tariff and non-tariff barriers to cross-border flows of raw and processed agricultural commodities, and increased the openness of financial markets, leading to increased capital flow into developing countries, especially in the form of foreign direct investment (FDI). Where structural adjustment reforms had substantially reduced state control over input and output markets, trade and FDI liberalization has paved the way for major investment in post-harvest processing and retailing in developing countries since the 1990s. This "new" capital investment differs from the structural adjustment era reforms in that whereas the focus previously was upstream, in the input, production, and wholesale sectors, more recent emphasis, especially in private investment, has tended to be downstream, in food processing, retail and restaurant markets. The exceptionally rapid diffusion of supermarkets in developing countries, in particular, has also been driven by improved coordination and communication technologies in addition to increased urbanization, lower prices of processed goods, increased per capita incomes in developing countries, as well as saturation and intense competition in foreign firms' home markets (Reardon and Barrett 2000, Reardon et al. 2003). In Latin America, for example, supermarkets currently account for 50–60 per cent of national food retail sale, compared with only 10–20 per cent in the 1980s (Reardon et al. 2003, Reardon and Timmer 2007).

The rise of supermarket and restaurant chains has changed the fundamental structure and operations of agricultural markets significantly, directing far more market power downstream, often to chains wholly or partly owned by multinational corporations. As R&vE document in the case of fruit and vegetable exports, retailers capture 34–46 percent of final retail prices versus only 4–14 percent for growers. Commodity procurement by retailers has become more centralized, with consolidated buying points at a regional, even global, level. It is not uncommon for a major supermarket chain located in three different countries to consolidate its procurement in a few large growers in just one of those countries. Global food chains have also established regional procurement nodes and in-country commodity procurement for regional firms has often been centralized from individual store level to provincial systems (Reardon et al. 2003). These structural shifts in value chains have increased contract farming and outgrower schemes between agro-industrial firms and farmers in developing countries, and production of non-staple foods has increased.

Increased foreign investment in agricultural markets in developing countries, however, has produced conflicting results. Increased industrialization of agricultural markets has fostered improved market efficiency and competitiveness, integration of formerly fragmented markets, product diversification through differentiation, and value addition and technology transfer. However, the rapid pace of structural change, with some developing countries accomplishing in a few years what developed countries accomplished over decades, has left limited room for adjustment by smaller, less well-informed, and poorly capitalized market actors to new ways of doing business. There is thus growing concern that market openness may lead to the replacement of traditional processors by oligopsonistic multinationals, accentuating the latent dualism of a modern, efficient marketing sector accessible only to those with adequate scale and capital, alongside a traditional, inefficient marketing channel to which the poor are effectively restricted. The tendency towards selection of a few medium- to large-scale firms or producers capable of delivering consistent quality product at large volumes has toughened competition for structurally inefficient producers, and seems to have led to some crowding out of smaller producers (Reardon and Timmer 2007). Local informal wholesalers and retailers have found themselves having to compete with bigger firms, both for the more efficient producers offering consistent product quality and throughput volumes, and for consumers seeking more services. The emergence of big, concentrated downstream private marketing intermediaries could also potentially lead, once again, to non-competitive agricultural marketing channels, effectively replacing government with private market power.

### What Roles for Governments and NGOs in Making Markets Work for the Rural Poor?

Markets plainly play a crucial role in the process of economic development. Yet, by virtue of the spatial dispersion of producers and consumers, the temporal lags between input application and harvest, the variable perishability and storability of commodities, and the political sensitivity of basic food staples, rural markets are prone to high transactions costs, significant risks, and frequent government interference. The relative power of developing country governments and private domestic or multinational firms in agricultural markets has varied over time. But the fundamental functions of input and output distribution, post-harvest processing and storage, as well as the persistent challenges of liquidity constraints, contract enforcement, and imperfect information, continue to challenge small farmers and herders, limiting their access to market opportunities, much less on favorable terms and in more remunerative niches such as livestock, fruits and vegetables and high quality export crops. The papers in this special issue document these patterns clearly and carefully.

So what are governments and NGOs, including faith-based organizations, to do? One thread of the arguments offered in these papers, clearly articulated by W&O and R&vE, is to identify market failures that retard private innovation and investment and to aim for interventions likely to crowd-in private investment. By fostering the creation and operation of effective producer groups, improving marketing infrastructure, enforcing private property rights and contracts, and helping foster rural credit delivery, these authors argue, smaller-scale producers might be able to climb up onto what appears a decidedly unlevel playing field. But as

Boughton et al. caution, if the impact of public goods and services in inducing market participation is perhaps limited and that it is more private wealth that fosters market participation in a reinforcing feedback loop—it takes money to make money—then this conventional prescription may prove unsuccessful, like so many past development interventions.

Here Wilson and Stapleford (hereafter W&S) offer a more provocative and original prescription based on the emergent concept of "transformational development" (TD). TD offers an alternative approach to rural development by focusing holistically on individuals, recognizing their sinful nature, and striving to transform their beliefs and behaviors and thereby to end the hopelessness that so often characterizes the extreme poor. As W&S describe it, "rather than a 'big push' to alleviate poverty…TD channels consistent programming to relatively small microeconomic units in the difficult or hard places of the world." Aggregating such individual transformative experiences across many persons, the objective is to build community and thereby to transform local cultures and thereby usher in institutional frameworks hospitable to market functioning, individual liberty, and economic growth, very much in the spirit of Bauer (1976), Landes (1998) and de Soto (2000). This perspective on the importance of individuals' views of themselves and others and on social networks as the foundation of market transactions in low-income rural settings characterized by weak rule of law is quite consistent with much of the cutting-edge economics research on market transactions in developing countries (Platteau 2000, Fafchamps 2004). These are messages dear to the hearts of many Christian economists who seek to restore the place of the cultural and spiritual to the study of economic phenomena (Dean et al. 2005).

Together, the set of four original papers that comprise this special issue offer an engaging set of ideas and arguments surrounding the current state of poor rural peoples' relation to markets in the developing world and strategies for improving those relationships. The topic is plainly of considerable and growing importance to policymakers in a world in which more than five out of six people live on $10/day or less and in which the reach of markets appears to be growing and changing on a nearly daily basis. For them and for Christians answering the scriptural call to care for the least among us, the economic riddle of how to make markets work for the rural poor remains quite incompletely answered.

## Endnote

1 Estimates from Pritchett (2006).

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