

Poverty Reduction: Making Markets Work for the Poor

International Development Enterprises (IDE)

Purpose of the Paper

1. This paper provides the framework for IDE's approach to poverty reduction. It seeks to make explicit the assumptions underlying IDE's efforts to integrate the rural poor into expanding input and output markets. Its aim is to demonstrate that there is a case for taking specific action to enable the poor—especially the rural poor—to participate in markets both as customers of purchased inputs, and as suppliers of high-value products. It argues that poverty reduction must be market-driven, whereby the purpose of public investment in poverty reduction should aim at removing constraints to market participation.
2. The paper is meant to be a draft for IDE internal discussion with staff and the Board, and at a later stage to serve as a tool to facilitate interaction with donor agencies, collaborating organizations, and to communicate with the outside world at large.

Poverty, Wealth Creation, and Markets

3. A consensus is emerging around the view that poverty is a multi-faceted phenomenon, encompassing issues of security and safety nets, self-esteem and belonging, as well as power and control. Determinants of chronic poverty and vulnerability are closely related to the volatility and low level of rural incomes, the deteriorating natural resource base, low food security, and high population growth. Much policy discussion focuses on “income poverty” (or, alternatively “consumption poverty”), both because it is the most amenable to measurement and because it connects to all the other dimensions. The international development targets suggest that the focus of poverty reduction be on identifying and addressing problems impacting on large numbers of people, rather than seeking larger gains in well-being for a few.
4. Since 1945 the countries of the non-industrialized world have made major efforts at stimulating modern economic growth. The outcomes of these various economic development strategies are at least as varied as the strategies themselves. Some parts of the less-developed world have experienced respectable economic growth during the last five decades. South Asia has witnessed growth of slightly lower than 2% per capita per year since 1965, and East Asia has grown at 3.5%. Other parts of the world have been less successful. Sub-Saharan has witness falling per capita GNP during the past thirty years, and Latin American economies have witnessed only slight positive growth rates.
5. How has economic growth affected the poor? While there is evidence today that over time, vigorous economic growth is associated with poverty reduction¹, in a large

¹ The elasticity of poverty, as measured by the change in the headcount index with respect to the changes in per capita income, is estimated to be between -1.5 and -3.5. At any positive rate of growth, the higher the initial inequality, the lower the rate at which income poverty falls. It is possible for inequality to be

number of developing countries the benefits of economic growth have not reached the poorest 20 to 40 percent: their share of income has fallen, and their absolute average income has remained approximately constant.² These findings do suggest that it is one thing to increase GNP at the fastest possible rate—hoping that the economic benefits will trickle down to the poor, and quite another thing to place the improvement of the welfare of the poor as the highest priority. The world community has clearly recognized this and multilateral development banks as well as many bilateral donors have started to put heavy emphasis on poverty reduction per se, as a quite separate and distinct development goal.

6. It is against this reality that the Board of IDE has decided that the organization is to put the poor first. Putting the poor first involves making choices concerning intervention strategies on the basis of consideration of how various alternatives will affect the welfare of the poorest strata of society.
7. Today it is generally accepted that poverty consists of two interacting deprivations—physiological and social. Physiological deprivation is an inability to meet or achieve basic material and physiological needs and can be measured as a lack of income, which limits access to food and to education, health, housing, water, and sanitation services. The question arises: how can the poor generate income—income that allows the poor to overcome physiological deprivation, and thus escape income poverty?
8. Markets—and especially access to markets—have a profound impact on the well-being of the poor. Poor workers sell their labor to landlords or factory owners. Poor farmers sell their produce to traders. Markets are institutions. They can be understood as ‘rules of the game’ and as organizations, which enable participants to trade in factors of production, or in outputs, or consumer goods and services. At least since the days of Adam Smith, economists have recognized that the driving force of wealth creation is the production of goods tradable outside the immediate area of production.
9. The poor are largely marginalized from commercial markets, depriving them of the opportunity to generate profits. To the extent that the emphasis of the development world is on the poor themselves, emphasis must be on incorporating the poor into markets. For markets to work better for poor people, they need to facilitate the access of the poor to assets, and enable them to use these assets to generate livelihoods and to reduce vulnerability. To do this—i.e., for markets to become pro-poor—markets must become progressively more developed, and accessible to poor people.
10. The driving force for wealth creation is market opportunities, and the ability to generate surplus income from taking advantage of such opportunities. Pro-poor markets are those that allow the poor to have access to market opportunities, and derive surplus income from such market access.

sufficiently high to result in rising poverty (Ravallion, Martin. 1997. *Can High Inequality Developing Countries Escape Absolute Poverty?* The World Bank, Washington, D.C.

² Note: insert table here, using data from World Bank (2000) and Daniel Little’s “Putting the Poor First.”

11. With market-driven income generation postulated as the true motor force for income generation, all other factors (such as policy, infrastructure development, technology, capital, information, and capacity building) can conveniently be identified as what they effectively are: factors that, when applied constructively, *enable* market participation.³

The Smallholder as a Market Participant

12. Of the total number of poor people living below \$1 per day, 75 percent, or 900 million, live and work in rural areas. Globally, nine of 10 of the developing world's rural poor live in either Asia or Sub-Saharan Africa. Asia dominates, with two-thirds of the total rural poor, who are concentrated in South Asia (43 percent). A significant percentage of the rural poor live in less-favored areas that are challenged by difficult agroclimatic conditions, such as poor soil, low and unstable rainfall, steep slopes, and short growing seasons, inadequate infrastructure and support services (roads, irrigation, markets, research and extension, credit, schools, and health centers. Only about one third of the rural population live in favored lands. However, many of these less-favored lands have good agricultural potential, particularly where roads and irrigation are available.
13. With a very large majority of the poor living in rural areas, the emphasis of poverty reduction strategies must necessarily be in rural areas. Added to this is the consideration that a wide range of non-farm activities in rural as well as in urban areas either supply production inputs to agriculture, use agricultural products as raw materials or involve the trading of agricultural products (Hazell and Hojjati, 1995).
14. With two-thirds of the world's rural poor living in low-potential areas, the topic of agriculture as the avenue to wealth creation can only be addressed if there are satisfactory answers to the question of how the problems of lack of water control and poor soils can be overcome.
15. For the past 15 years, IDE has zeroed in on low-cost water control technologies (including water lifting, water storage, and water distribution). With the development of extremely low cost microirrigation, a typical water installation for the efficient microirrigation of 750 square meters is available for less than the equivalent of \$200. As such locally produced systems can be installed on a modular basis, a smallholder may be in business for his/her first growing season with an investment of less than \$50 (and from which he/she may typically derive net additional income of at least that amount in the first season). Today, there is reason to believe that low-cost microirrigation and the resulting water control it gives to the smallholder is an important foundation on which commercial smallholder agriculture can be built.
16. Effective solutions to low soil fertility, and maintenance of soil fertility, largely exist today, but their widespread use requires intensive dissemination efforts. It is

³ This conceptualization of the market place makes it possible to avoid "factor driven" intervention strategies whereby the factors (such as technology, capital, policy, etc.) are postulated as development forces in and of themselves. That is, the true dependent variable is market participation, with technology, policy, etc. placed in a supporting, i.e., enabling role.

generally agreed that from the point of view of environmental concerns, economics, biological efficiency, and maintenance of soil structure, the intensification of smallholder agriculture on less favorable lands will need to be undertaken based on organic practices supplemented where necessary by additional, purchased inorganic nutrients.

17. With the emphasis being on (a) the rural poor as market participants, and (b) wealth creation, the question arises as to what markets the poor can profitably participate in, given their particular and limited assets endowment. This is a purely market-related question, with no preconceived notions as to the nature of the economic activities involved. There is, however, growing evidence that participation by the rural poor in commercial agricultural markets not only is possible, but also can result in sufficient net additional income that allows the smallholder to gradually pull him/herself out of poverty.
18. Based on observations as to how poor household families spend and re-invest their net additional income derived from market participation, IDE is suggesting that, on average, net additional income per family would need to reach at least \$500 (PPP) per year before the dynamics for effective income poverty escape would be reached.
19. For this to be possible, the rural poor must increasingly concentrate on the production of cash crops (i.e., crops that are intended entirely or primarily for market). Cash crops typically have a higher value than those consumed within the household, while the higher input usage associated with such crops and the increasing specialization in production associated with them, raise the efficiency of resource use in production. Cash crops thus typically generate higher returns to both land and labor than food crops.
20. Are there sufficient market opportunities for millions of smallholders to enter cash crop production from which they can derive significant additional income? Here it can be argued that (a) local, national, regional, and international markets for high-value agricultural products are constantly expanding due to rising incomes and rising populations; (b) through the facilitation of access to productive assets and to markets the smallholder community can indeed gain market share for selected high-value products; and (c) through the invisible hand of comparative advantage and relatively open markets, the overall agricultural production scene will realign itself such that there will be production specialization relative to the particular advantages of different market participants.
21. The literature shows innumerable instances in which smallholders have successfully and sustainably conquered market share through specialization, and have used these opportunities effectively to escape income poverty. The challenge is one of replicating these successful market participation examples on a very large scale.
22. Smallholder production IS NOT a simple extension—or scaling down—of production techniques used by medium- and large producers who are operating in favorable production environments. Rather, smallholder production systems must be re-invented to take maximum advantage of the particular assets endowments of the small farmer. This may be referred to as the “miniaturization” of the production of high value agricultural outputs, which must be embedded in unique production systems

that encompass (a) tailor-made supply systems (seeds, fertilizers, soil amendments, implements, etc.), (b) tailor-made production practices (practices that focus on the intensification of production, and maximization of the use of family labor, water, and purchased inputs on very limited land), and (c) tailor-made interfaces with output market systems (postharvest techniques, packing, transport). It is this re-engineering of the production system for smallholder purposes that ultimately leads to effective market participation by the poor, and lends competitive advantage to the rural poor for the production and commercialization of selected high value crops.

23. Greater exposure to markets entails risks. Combined with higher purchased input costs typically associated with cash crop production, these often serve to discourage poorer households from engaging in significant cash cropping activity. It is commonly the households that are able to produce enough staple foods to meet their own basic needs that invest in cash crop production (Jayne 1994; Govereh, Nyoro et al. 1999). This is often only the top quartile or fewer. This finding would suggest that intervention strategies leading to market participation must be preceded or accompanied by strategies that ensure the availability of enough staple foods at the household level to meet basic needs.
24. Similarly, women rarely share equally in the benefits of cash cropping. Rather, gains in cash crop income that flow their way are often offset by increased demands on their labor time. Where crops start out as “women’s crops”, control of production and marketing decisions is often assumed by men when the income-earning opportunities exceed those derived from more traditional men’s cash crops. Special, locally specific provisions must be made to enhance the benefits that women derive from cash crop-led growth.

Liberating Market Forces

25. Let us re-state here the basic tenet of this paper: effective market participation is at the root of wealth creation, which in turn, directly leads to the elimination of income poverty. By accepting this tenet, we also accept the notion that our starting point for poverty reduction must be with the identification of *market opportunities* with potential for smallhold participation. Everything else follows from there. Even though many factor-oriented development workers would wish to state otherwise, what comes first are market opportunities. To realize these opportunities, such factors as technology, credit, market information, training and capacity building then become important to consider and to bring to bear on the development of market access.
26. Naturally, markets for agricultural products are enormous. At the same time, food supplies must double over the next 20 years. And with rising incomes and consequent demand for higher value agricultural products, market opportunities for smallhold producers is constantly expanding.
27. Markets may be distinguished by local, national, regional, and international markets. *Local markets* may typically be characterized as informal, most players operating on a small scale, short marketing chains, generally low margins, little emphasis on quality, high seasonality, reasonable information flows, and significant other inefficiencies (peri-harvest losses, glutting). *National markets* in most poor countries

may be characterized as still largely informal, most players operating on a modest scale, longer marketing chains than in local markets, but little development of cool chains, significant price volatility due to limited information flows and high perishability, high seasonality, limited added value through small-scale processing, profit margins generally low, but marketing costs often high due to transport, roads and communications infrastructure, and price premia for good quality and supplies out of main season, but still relatively little emphasis on quality overall.

28. *Regional markets.* Significant levels of regional trade occur in many agricultural products, mainly fresh fruit and processed foods. It appears that regional markets have not yet succumbed to the quality- and safety driven pressures for closer vertical integration within supply chains that are now such a major feature of western-style markets. This means that there are still opportunities for relatively poor producers to participate in relevant supply chains.
29. *International markets.* International markets for agricultural products are large and expanding. Global markets for citrus products may serve as an example: some 10 percent (9.7 million tons) of the world total production (89 million tons) is exported. Similar percentages are reported for mangoes, avocados, papaya, and other fruits. However, low income countries do not feature significantly in international trade statistics, primarily because (a) exports require a high degree of infrastructural and institutional development (even where smallholders are able to link up with export markets, it is only likely to be those in the most accessible, best serviced areas); (b) quality requirements are getting ever stricter. Western states are continually tightening their sanitary and phytosanitary requirements; and (c) pressures from the major retailers that dominate many supply chains are forcing importers to rationalize the number of suppliers with whom they do business, in the process focusing on larger companies that can not only meet quality requirements, but can also enact quality assurance programs.
30. To make local, national, regional and international markets increasingly work better for poor people requires market development through transaction costs falling, information flows improving, and integration increasing. In the case of smallholders, market development may also need to occur through the creation of new markets where none existed before. There are circumstances in which markets can and do exclude the poor, notably those that are destitute and have little to offer the market.
31. An essential feature of improving market performance for the poor is the ability to deal with *market failure*⁴, both in a particular market and in linked markets. For example, failure in credit markets will often restrict the ability of farmers to hire in

⁴ The term “market failure” as used here is as it is understood in welfare economics literature which identifies the following types of market failure: *Public goods* (which the private sector will not supply, or will under-supply, because it cannot appropriate the benefits); *externalities* (which exists when the production or consumption of a good or service has spill-over effects which are not reflected in the market price); *market power and economies of scale* where barriers to entry create market power, enabling monopoly rents to be earned and depressing production; *asymmetric information* (where parties to a transaction have different information about the nature of the exchange; in credit and input supply systems, information failures are especially widespread); *cost of establishing and enforcing agreements* (where these costs are so high as to increase risks to the point at which markets do not exist). (DFID 2000)

labor. Correcting for market failures provides one widely accepted justification for market intervention. In the case of pro-poor markets intervention to correct for market failures often is an absolute necessity.

32. To a large extent, income poverty exists because of the absence of pro-poor markets, which can largely be explained by market failures of existing markets with respect to smallholder participation. Correcting for these market failures on the one hand, and developing the comparative advantage of smallholder production for selected agricultural products on the other hand, becomes the pivotal point of any intervention strategy aimed at making markets pro-poor.
33. Market participation by the rural poor⁵ requires that they have access to a minimum of productive assets. Aside from the true destitute, practically all rural poor do have access to at least some productive assets, such as land, water, family labor, and reading and writing skills. IDE has proposed that effective market participation requires that in addition to some basic productive assets, the smallholder be embedded in a market support system that provides the following four factors: technology, training/capacity building, capital/credit, and market information.
34. *Technology* must be uniquely conducive to help maximize the use of the productive factors of the poor. As such technology must be divisible, very low-cost, and highly appropriate to the conditions of the smallholder. Technology may be in the area of inputs (e.g., water control implements, small-farm adapted improved seeds), farm intensification (e.g., management practices), or output markets (e.g., postharvest practices, packing, transport). In very large measure, smallholder-friendly technologies are not available, and require development. While it is possible that the private sector that has discovered the smallholder producers as a reliable source for high quality agricultural products is willing to engage in R&D efforts that would result in technologies of the type described here, it must be recognized that the development of basic technologies is a public good. Much needs to be done to re-orient international, national, and local R&D activities to the needs of pro-poor markets.
35. *Training/capacity building*. To be successful, pro-poor markets must live up to the same standards as any other market. This requires a high degree of know-how and training on the part of the market participants (suppliers, producers, traders, etc.). In mature markets, much of the training and capacity building is provided for on a commercial, self-paying basis. In pro-poor markets, it can be expected that the private sector will gradually be able to provide more and more training services on a for-profit basis (either receiving direct payment, or through service-embedded payment). However, as is the case with technology, much of the initial training and capacity building needs to be provided in the form of a public good. Again, much remains to be done to focus public training and capacity building efforts—including extension services—to the needs of the pro-poor markets.
36. *Capital/Credit*. Pro-poor markets need capitalization of course. Capital is needed for investments in infrastructure, and for cash flow purposes, at all three levels: the level

⁵ The rural poor whose market integration this paper is concerned about include: small-scale poor farmers; landless poor families, small-scale traders and entrepreneurs, and peri-urban poor families. These people might participate as harvester-producers, laborers, processors, and traders.

of supply chains; the level of the smallholder (mostly in the form of micro credit); and the level of buyers, traders, and processors. While there is no reason to postulate that capital requirements for pro-poor markets must be provided on a subsidized basis, it is important to ensure access to capital in the form of loans through such mechanisms as loan guarantees or direct loans as increasingly being made available by the World Bank, multilateral development banks, and other development-oriented investors. IDE estimates that a typical pro-poor market system will require capital investments of approximately \$5 million dollars for a pro-poor market system comprising 10,000 smallhold producers.

37. *Market Information.* For a pro-poor market system to operate efficiently, a high degree of market information must be available and accessible to all market participants. With the information revolution having gained sufficient momentum to penetrate all corners of the world, the structuring of efficient and relatively low-cost information systems for participants in pro-poor markets becomes increasingly more feasible. As is the case with technology and capacity building, investments in information systems for pro-poor markets requires participation of both the public and private sectors.

Removing Constraints

38. The question arises: why is it that the poor are not participants of commercial markets, both as purchasers of input, and as efficient producers of high value outputs? The answer, as demonstrated above, lies in the fact that there are distinct market failures in existing markets, and that the poor as potential market participants are not embedded in a market system that provides them with access to technology, training/capacity building, capital/credit, and market information.
39. IDE has suggested that the integration of smallholder markets in pro-poor markets requires a public investment in the form of a market intervention strategy. This investment is essentially a one-time investment, and serves to remove the basic constraints to market participation in any given market situation.⁶ IDE has reason to believe that on average, it may take some six years of market facilitation work to prepare a given pro-poor market setting to gain a sufficient level of integration so that it may acquire the momentum to sustain itself—and expand—without the need for further publicly provided market development facilitation.⁷
40. And how are publicly funded market intervention strategies to be designed and implemented? Operating under a market development perspective, IDE recently has sought to integrate a series of analytical tools including subsector-, commodity

⁶ To be sure, as all agricultural markets in the world are subsidized markets (through import restrictions, direct subsidies, provision of numerous public services ranging from R&D to extension services, etc.), it would be impossible unfair and counter productive if pro-poor markets would artificially be excluded from policy and other public support mechanisms. As a matter of fact, poverty alleviation concerns would dictate that many of the public support mechanisms be adjusted so as to disproportionately favor market participation by the poor.

⁷ Current estimates are that on average, the cost of such market facilitation is approximately \$2.5 million for a market setting with 10,000 smallholder participants. (This does not include the cost of publicly provided R&D and extension services, nor accompanying investments in infrastructure development—such as roads, development of water sources, etc.)

systems-, business-development-services markets-, and output market analysis. The purpose of this integration of analytical tools was to identify market opportunities for smallholders in given market environments (IDE refers to these market environments as “market sheds” similar in nature to “water sheds”), and at the same time, to identify critical constraints that require removal if a significant portion of the smallholders in the marketshed⁸ are to become integrated in commercial market systems.

41. IDE has gone one step further: it has applied its methodology for the creation of pro-poor markets in six different marketsheds in six different agroclimatic zones in Asia and Sub-Saharan Africa, with the aim reaching a total of 160,000 smallholders in a six-year time period. The purpose of this undertaking (referred to as Core Action Research and Development Program, with CARDEP as its acronym) is to test and further develop the market intervention model, with the aim of making the methodology widely available.
42. In a recently published study (World Bank 2001) IDE and Winrock International point out that market intervention programs such as the one described here may well have the potential to reach up to 30 million smallholder families in Asia and Africa alone thus assisting them to become integrated into expanding market systems, and do so by the year 2015. Such integration would constitute a significant contribution towards the International Development Target of reducing by half the proportion of poor people in the world by 2015.

Focusing on the Realization of a Common Vision

43. Poor households in rural areas—those that make up the large majority of the extremely poor people in the world today—live in an environment of subsistence. They depend on some agricultural production, small-scale entrepreneurial activity, and sometimes a remittance from a family member. None of their income sources are secure, which leaves literally hundreds of millions of people in a state of economic disempowerment. Their marginalization from the market place can be rectified to the extent that they can use their limited assets to produce and sell marketable product, thereby becoming members of expanding markets. With net additional resources available in the local community, people will provide services to each other, circulating money that will lead to new and expanding markets.
44. Without an initial basis for market participation, poor people will remain marginalized. Clearly, an initial push is needed. The approach suggested in this paper argues that a publicly funded intervention to remove the basic constraints to market participation is one of the most promising avenues to bring about effective income poverty reduction. The intervention strategies espoused by the present approach rest on the assumption that the smallholder subsector has the potential to develop comparative advantage for the production and marketing of high value agricultural products, provided that the subsector has access and control over water,

⁸ Marketsheds may vary in size depending on the relative homogeneity of the smallholder population under consideration, and the availability of resources for the intervention program.

and has access to technology, training, capital, and market information—all in a form that is conducive to this sector.

45. A public investment in the development of these four factors, combined with a project approach aimed at facilitating the process of gaining market access, may well prove to be a powerful approach to market development for the rural poor that will attract increasing private investment and prosperity in the rural sector.
46. To the extent that this vision is shared in the development community, development agencies, the NGO community, and the private sector, an international alliance in pro of market development for the poor may emerge, which has the potential to focus the world's attention on the challenge of how to let hundreds of millions of poor people in the wealth of nations. This is the goal that IDE is committed to, and to which it hopes to make a small yet important contribution.

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