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Critical Linkages: Livelihoods, Markets and Institutions.

Imperial College Wye

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Abstract

The benefits of livelihoods thinking and approaches are widely recognised. This paper focuses on an important gap in much of the conceptualisation and application of 'livelihood approaches', a lack of emphasis on markets and their roles in livelihood development and poverty reduction. The omission is important as it can lead to failure to identify and act on market opportunities and constraints and on related institutional issues. The paper explores these arguments in more detail and suggests ways in which they may be addressed before concluding with a brief illustration of the application of the paper's arguments to a desk study on rural market development in Africa.

Critical Linkages: Livelihoods, Markets and Institutions.

Andrew Dorward, Nigel Poole, Jamie Morrison, Jonathan Kydd and Ian Urey

1 Introduction

The benefits of livelihoods thinking and approaches are widely recognised, including, for example, its stress on the importance people centred change, a holistic approach, people's access to different assets, poor people's vulnerability, partnerships, sustainability, change, and the multi-faceted nature of livelihoods. We focus in this paper, however, on what we argue is an important gap in much of the conceptualisation and application of 'livelihood approaches', a lack of emphasis on markets and their roles in livelihood development and poverty reduction. Given that one of the roots of livelihoods thinking was Sen's concept of entitlements, this is surprising. The omission is important. If the roles of markets and market relationships are not properly addressed in livelihoods analysis and action, then it can lead to failure to identify and act on (a) livelihood opportunities and constraints arising from critical market processes and (b) institutional issues that are important for pro-poor market development. These are intimately related to macro- and meso- processes of change in national and local economies. This paper explores these arguments in more detail and suggests ways in which they may be addressed. Discussion focuses particularly on the SL approach as developed and applied by DFID.

We begin, however, by asserting the importance of markets and the private sector for pro-poor livelihood development and poverty reduction. This follows from four observations: first that the livelihoods of most poor people are directly dependent on their involvement in a range of markets as private agents or as employees (and are indirectly dependent on the wider economy for the demand and supply of goods and services); second that major current and historical poverty reduction processes have depended on equitable private sector economic growth (but we note later the importance of actions by other stakeholders – such as CBOs and the state – in market development); third that poor people themselves often identify problems with markets as critical to their livelihoods (but these problems may concern both the absence of markets and the effects of markets); and fourth that in support of such growth, markets can provide a highly efficient mechanism for exchange, coordination and allocation of many resources, goods and services, *but they often fail*. Recognition of the frequent failures of markets to serve the interests of the poor is critical to the arguments of this paper: we examine some of the reasons for these failures and argue that conventional promotion of liberalised competitive markets is often misplaced. A more imaginative approach is needed, rooted in a stronger understanding of the importance and nature of institutional development in economic growth, with market development being one part of that institutional development.

We stress that although we see improved market access as critical driver of sustained and broad based poverty reducing development, it is neither a magic bullet nor a sufficient condition for such development: other social, political and technical processes of change are also vital. With the very real difficulties that the poor face in accessing markets, ongoing actions to support livelihoods in the absence of market access are important in many instances. Expanded market access can also pose real threats to the livelihoods of poor people. The core of our argument here is an appeal to two different development communities. To 'market sceptics', we put forward what we suggest is a realistic understanding of markets' potential and of their problems, and plead that action should be compatible with and complement the longer term potentially powerful market processes for pro-poor growth. To 'market fundamentalists', we call for (and offer) a realistic, pragmatic and theoretical understanding of problems of market based development, and suggest some of the ways that these may be addressed.

2 Market opportunities and constraints in livelihood development

A useful question to open up this topic is to ask what market and private sector thinking have to say about sustainable livelihoods and poverty reduction. This has to be related to wider dynamic processes of growth in local and national economies, to the two-edged sword of competition (both a force for

increasing economic efficiency with lower prices for consumers, and a threat to particular stakeholders, poor and non-poor), to markets (their roles, their nature, the characteristics of pro-poor markets, the importance of, for example, labour markets), to institutions supporting markets and other means of exchange and coordination, and to the dynamics of livelihood change and of relations between the livelihoods of different poor and non-poor stakeholders. Perhaps the most important point is that development of livelihoods critically depends upon, among other things, demand for the outputs (goods and services) supplied by those livelihoods.

Many of these issues are easily overlooked in livelihood approaches that (usefully) focus on the more immediate situations, opportunities and constraints facing particular groups of poor people. Such analysis can easily overlook the dynamic opportunities and constraints posed by wider market interactions. An important illustration of the importance of these issues is the on-going debate about non-farm diversification in rural livelihoods.

The growing extent and importance of rural livelihood diversification out of farming is increasingly recognised: typical observations in Africa are that (a) the less poor often have more effectively diversified incomes and (b) the poor tend to be stuck either in low return farm activities or in low return non-farm activities (with difficulties in agriculture pushing them into the latter). Taken at face value these observations can lead to simplistic policy responses to expand opportunities for higher return non-farm enterprises. However, more nuanced analysis of the dynamics of livelihood and economic development and of market access tends to show that (a) many non-farm activities are dependent directly or indirectly on agriculture, and (b) the poor often lack access to higher return non-farm activities through lack of financial, social and human capital (see for example Barrett, Reardon, et al., 2001, Reardon *et al.*, 2000). Policies that ignore agricultural growth and that support higher return non-farm enterprises without addressing the factors constraining the access of the poor to these opportunities may then end up helping the better off more than the poor.

With regard to the first of these two points, a long-standing theoretical and empirical literature has examined the linkages between different activities within rural economies (for recent reviews see for example (Delgado *et al.*, 1998, and Dorward *et al.*, 2001). Examination of linkages allows exploration of the effects of exogenous change as they work through different elements of the rural economy.

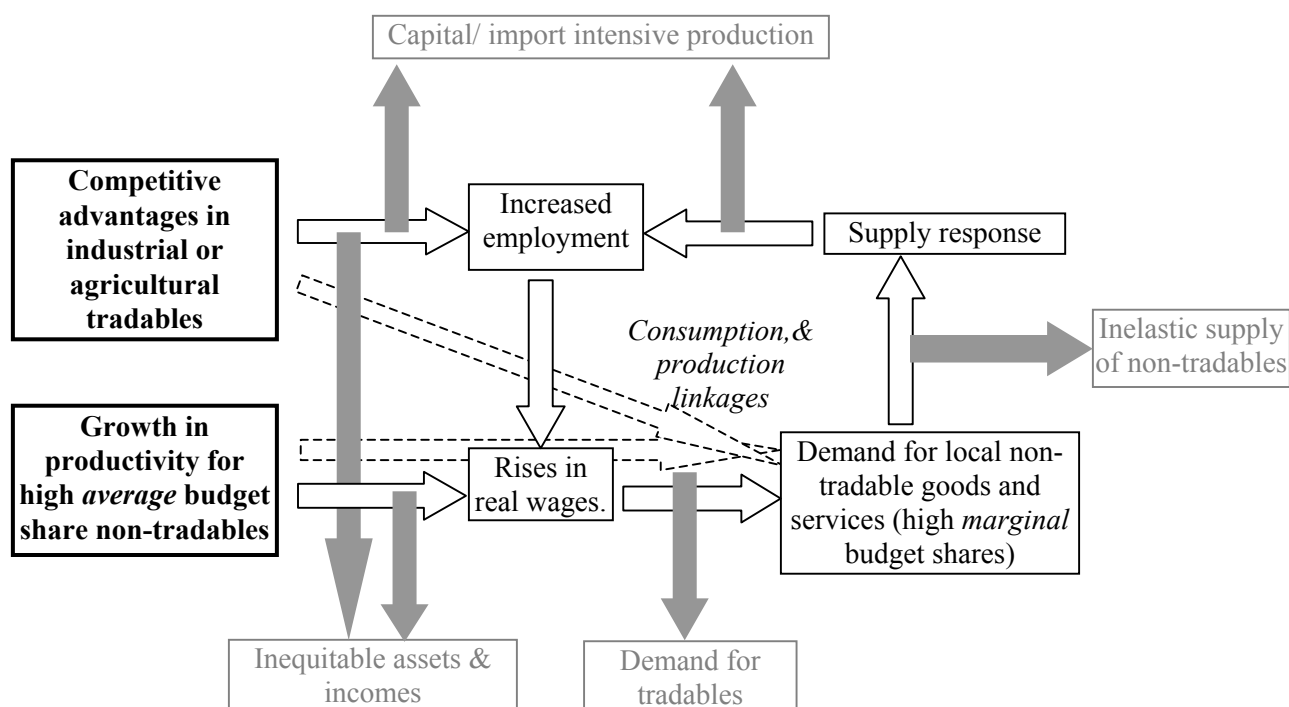


Figure 1. Linkages and leakages in a local economy

Figure 1 summarises the key linkages between processes of livelihood change and market access on the one hand and on the other wider processes of growth and a ‘virtuous cycle’ whereby production and consumption linkages allow the stimulus of some production or market opportunity to feed back into increased demand for labour and for locally produced goods and services¹. However, the ‘leakages’ from this virtuous circle also need to be recognised. Understanding of these linkages and leakages may help in understanding the markets and activities that will have wider positive impacts on the livelihoods of the poor and on the opportunities available to them². An important conclusion from the linkage literature is that the effects of particular changes on a rural economy and on poor people within it depend crucially upon the nature of the change, on the structure of the local economy, and on different poor peoples’ places within it. Regard must be given to the local demand characteristics of goods affected by price or productivity change (their average and marginal budget shares for different income groups), tradability,

¹ A critical distinction is made between tradable and non-tradable goods and services, tradable goods and services being those that may be imported or exported to or from the area. In practice the distinction between tradables and non-tradables is often not distinct, varying with (a) the scale or the boundaries of an area (the larger the area the greater the proportion of non-tradables), (b) its accessibility (the less accessible the greater the proportion of non-tradables) and (c) the comparative production costs inside and outside the area. These factors together determine the relationship between local costs on the one hand and the spread between ‘import’ and ‘export’ parity prices on the other. Although these terms are often associated with international trade, they are equally applicable to *intranational* trade between different districts or between rural and urban areas.

² DFID, 2001 draw a distinction between markets that the poor participate in directly and markets that they benefit from indirectly as a result of such markets contributing to wider pro-poor economic growth.

and local production characteristics (supply elasticities, labour and tradable input demand, upstream and downstream linkages) as well as the operation of factor markets that affect both elasticity of supply and the distribution of income within the rural economy.

An appreciation of linkages within local and national economies allows us then to examine how growth in the farm and non-farm sectors compares with regard to their supply, demand and linkage characteristics and hence their likely poverty reducing benefits? There are unlikely to be many *tradable* non-farm activities apart from mining that offer broadly based employment opportunities in the poorest (relatively low income and isolated) rural areas³. Only as links with urban areas develop will opportunities for non-farm tradable activities develop, but these will often be ‘high barrier to entry’ activities, limiting the benefits to the poor (Barrett *et al.*, 2000). Farm activities, on the other hand, are more likely to offer opportunities for broadly based expansion in tradable activities (whether cash crops or tradable food crops), with direct and indirect employment and income opportunities for the poor, again depending upon barriers to entry associated with, for example, the nature of the crop, marketing systems, access to land, etc.. Even here the poor are unlikely to gain much directly as self-employed producers of tradable agricultural commodities, with limited access to land and capital and relatively low on-farm incomes. However, there is often considerable potential for them to benefit directly (from increased labour demand from significant numbers of less poor farmers producing tradables) and indirectly (through increased demand for non-tradables from these farmers). The challenge is then to improve the access of less poor farmers to the skills, capital, inputs and output markets to allow them to respond to opportunities in production of farm tradables, and to improve access by the poor to linkage benefits.

Growth and poverty reduction through increased productivity of *non-tradables* will be effective as a basic source of poverty reducing growth where the non-tradable is widely consumed (i.e. has a high *average* budget share), either by the poor themselves or by a large non-poor population (with consumption linkage benefits for the poor) High average budget shares for food crops in rural areas in Africa (Delgado *et al.*, 1998) suggest that farm activities are more likely to meet these criteria than non-farm activities. Growth and poverty reduction through increased productivity of non-farm non-tradables with high *marginal* budget shares is more likely to be important as a secondary growth process, supporting consumption linkages. Institutional or technological change in non-tradable production may also have important redistributive effects by bringing down barriers to entry for poor producers and allowing them to gain market and income shares from less poor producers, as well as lowering prices to poor consumers.

These arguments are summarised in Table 1. A broad conclusion, to which there will be significant exceptions, is that in many poorer rural areas increasing productivity of farm activities will have greater potential for stimulating poverty reducing growth. Increased productivity of non-farm activities is likely to have greater poverty reducing benefits in supporting secondary, linkage dependent poverty reducing growth, again particularly if the activities have low barriers to entry and high labour demands. It can be further argued, from historical experience and from examination of the linkage and budget share characteristics of different types of agricultural production, that within agriculture, intensive cereal based growth offers the best prospects for sustained poverty reducing growth (see for example Dorward and Morrison, 2000)⁴.

³ See Wiggins, 2001 for a fuller discussion of these issues. Tourism and crafts may also offer opportunities for non-farm tradable activities, but, as with mining, areas with these opportunities are likely to be the exception rather than the rule. Migrant labour and remittances may also be considered a form of tradable, exporting labour to bring extra income into an area.

⁴ The importance of oilseeds in India’s second (rainfed) green revolution (Smith, L. and Urey, 2002) challenges the argument that intensive cereal based transformations have historically provided the most sustainable and pro-poor pattern of growth. However in the Indian context oilseed crops may have many characteristics of cereals as regards their linkages within a large domestic market, and oilseed growth has been associated with growth in cereals. This is a topic that needs further examination.

Table 1: Potential of Farm and Non-farm Productivity Growth in Reducing Rural Poverty

| | Tradable | Non tradable |
|----------------------------|--|--|
| Farm activities | Direct gains if high labour content by poor producers or large upstream / downstream linkages have high labour content by poor producers | Direct gains if high average budget share for poor consumers |
| | Indirect gains if high labour content by the non-poor and the poor benefit from expenditure linkages | Indirect gains if high average budget share for non-poor consumers and the poor benefit from expenditure linkages |
| Non farm activities | Potentially important gains from expenditure linkages for activities with high elasticity of supply and low barriers to entry and producing goods and services with high marginal budget shares (e.g. horticulture, livestock) | Limited direct or indirect gains as unlikely to have high average budget shares for poor or less poor consumers in poorer rural areas |
| | Apart from mining, other NR activities and migrant labour/remittances, unlikely without good communications and strong urban or export markets, features generally absent from poorer rural areas. | Potentially important gains from expenditure linkages for activities with elasticity of supply and low barriers to entry producing goods and services with high marginal budget shares (e.g. services) |

The operation, extent and terms of access to different markets are then critical questions, which are rightly, being given attention in on-going studies of rural diversification (for example in the LADDER project). What we are arguing here is that these issues need to be given much more prominence in our ‘basic’ conceptualisations of livelihoods. We propose later in the paper ways in which this may be achieved, but turn now to examine the question that immediately follows if we accept the importance of market development: how can pro-poor markets be developed? Here we need to consider the role of institutions, entering what, in the DFID framework, is sometimes considered the ‘black box’ of PIPs (Policies, Institutions and Processes).

3 Institutional issues in pro-poor market development

Following North, 1990 and Hall and Soskice, 2001, we define institutions as ‘rules of the game’, defining the incentives and sanctions affecting people’s behaviour. Key concepts relevant to our arguments here are the distinction between the institutional environment and institutional (or contractual) arrangements (Davis and North, 1971); the interaction of these with property rights, information flows, transaction costs, transaction risks, and market access failures for different market participants (e.g. Williamson, 1985, 1991, Dorward, 2001a); and processes whereby institutions change (North, 1990). The key point that emerges from an examination of institutional and economic development using these

concepts is that less developed economies are characterised by situations with high transaction costs and risks, weak information flows, and a weak institutional environment: actors, particularly those with little power or financial and social capital, face high costs in accessing information and property rights enforcement. This inhibits access to markets and market development. This in turn inhibits economic and technological development, and low levels of economic activity themselves lead to thin markets, high transaction costs and risks, and high unit costs for infrastructural development. The result can easily be a 'low level equilibrium trap'. We are left with critical questions about (a) the processes by which institutional, technological, social and economic development can proceed and (b) the roles of different stakeholders in promoting such development, particularly development paths that will involve and benefit the poor.

One important approach to follow in addressing this question is to consider the political economy *processes* of institutional change. Again North has made a seminal contribution here with a historical perspective on the influence of different paths of institutional change on economic development (North, 1990; North, 1995; Davis and North, 1971; North and Weingast, 1989). Institutional change is explained in terms of responses of powerful groups to changes in relative prices, technologies and transaction costs. These groups respond by modifying institutions in ways that they perceive to be in their interests. It is quite possible that in different countries the same sets of changes in relative prices and in transactions technology could stimulate radically different types of institutional change. Much depends upon (a) the perception by different groups of the possible opportunities and threats posed to their interests by alternative paths of institutional change or stagnation, and (b) their political effectiveness (locally, nationally and internationally) in influencing the paths and pace of institutional change. In broad terms institutional change can take an "anti-development" form (structuring transactions to create rents), or a "pro-development" (structuring transactions to reduce costs, thereby providing incentives for more trade and investment). There is a strong "path dependency" in these processes of institutional change, as development history plays an important role in determining both the relative perceptions and power of different groups on the one hand, and the institutional and technological options that they face on the other.

In addition to considering the processes of institutional change, we also need to look at the *types* of institutional change that may be required if economies and communities are to climb out of the 'low level equilibrium trap' described above. The emphasis of the current dominant policy consensus (as outlined, for example, in World Bank, 2000, 2002 and IFAD, 2001) is almost exclusively on the institutional environment (it lacks formal attention to institutional arrangements) and on the role of the government and civil society (in improving communications, property rights, the macro-economic environment, and access to information to support neo-classical competitive markets). These are, we believe, very important, but unfortunately if the institutional analysis stops there its principal output is a growing list of often unrealistic demands on governments. It becomes clear that the liberalisation agenda of the 1990s that emphasised and tried to escape the serious problems of state failure in market interventions has again run up against the buffers of serious state failure, but now these failures are in providing the institutional support required for privatised markets to develop and work in the challenging conditions where poverty is most intractable.

How can we move beyond this impasse? We suggest that the institutional analysis needs to be taken forward in a number of ways. First, we need to recognize an inherent contradiction between the broader conceptual framework emphasizing neo-classical competitive markets and an important, pragmatic thread that runs through conventional development wisdom, calls for support for bottom up non-market organisations (in producer groups, CBOs, other stakeholder groups, micro-finance groups, and common property resource management groups for example). These are not parts of a competitive market structure, but it appears that they can work: policy analysis needs to catch up with praxis, and we need to integrate them into an overall conceptual framework.

A more comprehensive conceptualization of markets as institutions (and hence part of the process of institutional development), however, overcomes these problems. Two practical policy conclusions arise from this: first that competitive neo-classical markets are then seen as only one institutional model (albeit

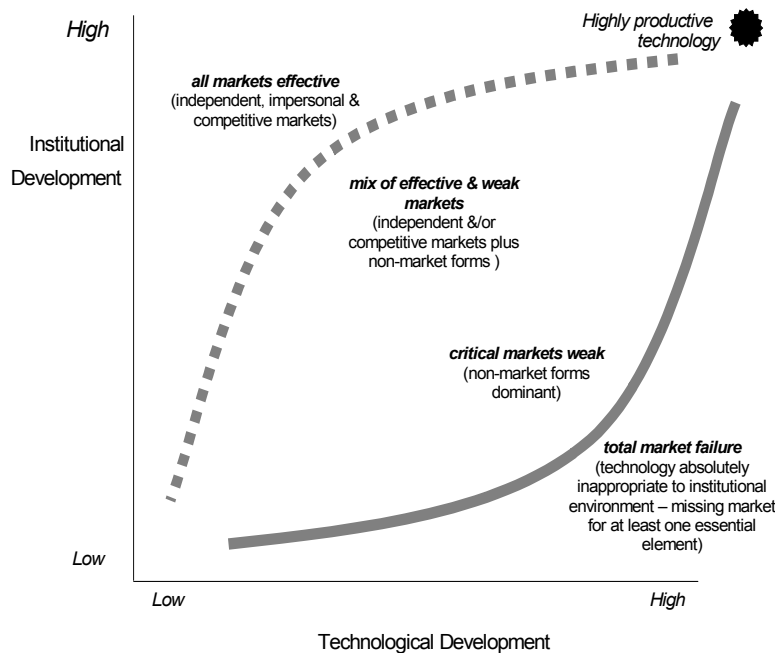
a very important and effective one) by which resources, production and consumption are allocated, coordinated and exchanged in an economy; and second that economic development involves the development of institutional arrangements as well as of the institutional environment. These points merit further consideration.

With regard to competitive neo-classical markets being only one institutional model for allocation, coordination and exchange in an economy, this is not to deny its many advantages, and efficiency and effectiveness in performing these functions. However, the conditions under which markets are efficient are quite restrictive (requiring, for example, a well developed institutional environment for information flows, property rights enforcement, and low cost, low risk exchange of clearly defined and standard goods and services) and even in the most developed economies a very significant proportion transactions are not conducted in competitive markets but instead are conducted within firms and in long term relationships between firms (see for example Coase, 1992, Williamson, 1985, 1991, Hall and Soskice, 2001). Globally the proportion and amount of transactions occurring within firms (and therefore through non-market arrangements) is growing as two thirds of world trade is either within transnational corporations (TNCs) or associated with TNCs (United Nations, 1999 cited by Yusuf, 2001). For transactions within developing countries (with much lower densities, smaller scales of economic activity, smaller transaction sizes and a less developed infrastructural and institutional environment) these conditions are much more restrictive. Under these circumstances alternative institutional models may perform more effectively, and indeed neo-classical competitive markets may not perform at all.

Figure 2 (from Dorward *et al.*, 1998) provides a simple representation of this view of economic development. The basic postulate is that technological and institutional development are two key, interacting and endogenous elements in economic development. Highly productive technologies require intensive and effective mechanisms for complex coordination and exchange, to allow investment in and operation of different specialized activities. These mechanisms in turn require effective institutions. Economic development is therefore shown in figure 2 as a movement from the south west to the north east, with complementary progress in institutional and technological development.

Simplistic and highly stylized though it may be, this simple representation poses a number of important and interesting questions. We limit ourselves to discussion of two. First, it helps us to conceptualise a mapping of different combinations of the two dimensions of institutional and technological development, and to ask how the exchange and coordination mechanisms for particular technologies may be provided in specific institutional contexts. Poorly developed institutions cannot support highly advanced technologies, and therefore in the south east of the diagram we encounter market failure. In the north west corner, however, high levels of institutional development should allow effective competitive markets to support relatively simple technologies. Along the south west to north east diagonal there is more ambiguity: here institutional development may be insufficient to support the competitive markets required for the coordination and exchange necessary for particular technologies. Market failure is not, however, the only alternative to well functioning competitive markets. Where institutions are not sufficiently developed to support these markets, actors will often develop other (non-competitive or non-market) arrangements for coordination and exchange, which may operate more effectively and more efficiently than liberalised competitive markets. There is, therefore, no *a priori* reason for expecting an optimal development path or movement from the south west to the north east to be restricted to situations with 'all markets effective': it is more likely to move through a mix effective and ineffective competitive markets with non-market institutional arrangements. Two immediate conclusions follow from this. First, current policy emphasis on institutional development to promote competitive markets may be sub-optimal in terms of its effectiveness in promoting economic development, and particularly in promoting economic growth for the poor, who tend to operate under conditions that present the greatest challenges to liberalized competitive markets. Second, if non-competitive and non-market forms are likely to be important and indeed desirable mechanisms for economic coordination and exchange, we need to develop a much better understanding of their operation, of the ways that they change, and hence of ways in which policy can promote pro-poor change.

Figure 2. Technological and Institutional Development and Market Forms



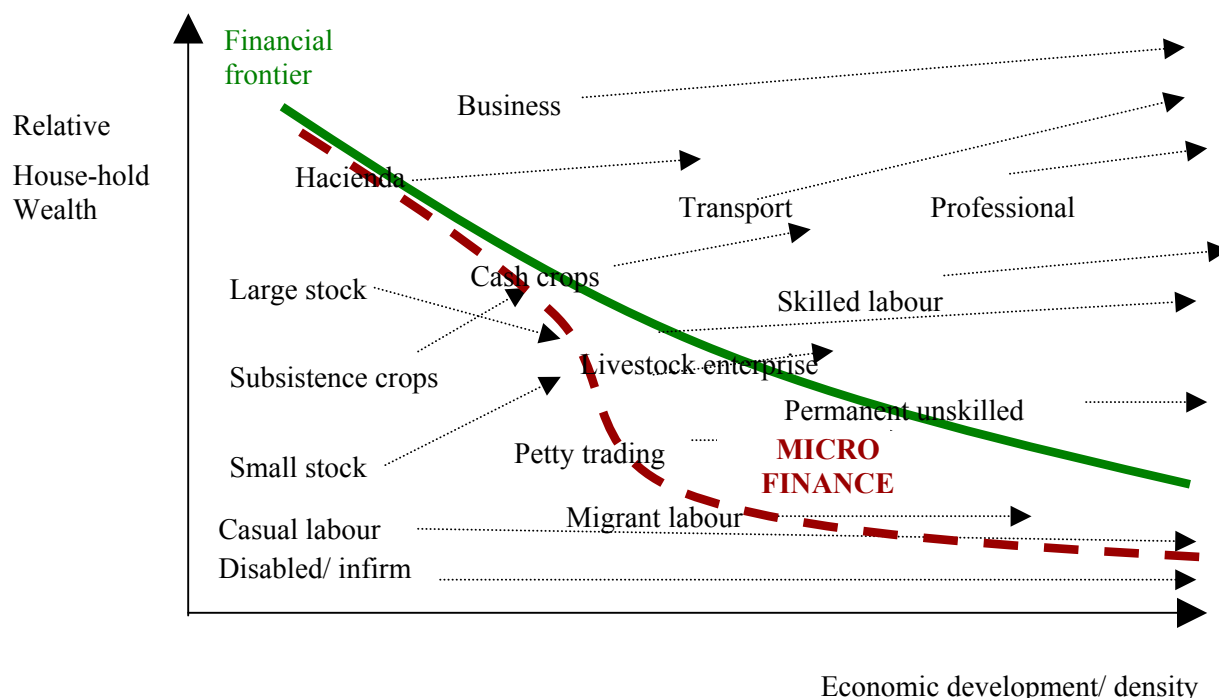
We illustrate this analysis, and the points that emerge from it, by examining two major, if often controversial, processes of change in developing countries in the last 50 years, the ‘micro-finance revolution’ and the ‘green revolution’.

The micro-finance revolution has at its root the interaction of two processes of change in the 1970s and 80s: the development of the Grameen Bank in Bangladesh (see for example Jain, 1996), and the Washington critique of development finance (see for example Von Pischke *et al.*, 1983). Although these initially developed independently, the synergies between them soon became apparent: a particular institutional model (i.e. a set of non-market institutional arrangements) was developed to address widespread market failure in financial markets for the poor. At the same time the failings of the hitherto dominant institutional model for agricultural and rural were being increasingly recognised, in the context of growing dissatisfaction with direct government involvement in markets. The Grameen Bank and other micro-finance initiatives expanded dramatically, in their spread and in the volumes of savings and loans that they handled. The achievements of the micro-finance revolution remain the subject of much debate, in particular its ability to reach the poorest and the dangers of over-crowding and competition between micro-finance suppliers. However, the point that we would like to make here is that it has resulted in improved access of many poorer people to financial services, and that this has been achieved by complementary change in the institutional environment, in institutional arrangements, and in technology.

This is illustrated in figure 3, which extends von Pischke’s concept of the financial frontier (Von Pischke, 1993) to loosely consider the ways that population density, economic activity and wealth affect households’ access to financial services, in the context of people’s concerns with livelihood strategies that involve pathways and transitions from one set of activities to another. Figure 3 suggests, in a highly stylised way, (a) a range of possible livelihoods that people may engage in in local economies with different densities of economic activity; (b) ‘livelihood development pathways’ by which they may seek to improve their lot as economic growth occurs, (c) the relationship of livelihood strategies and density of economic activities with the ‘frontier’ of access to formal financial markets, and (c) the contribution of micro-finance in shifting that frontier to extend access to financial services for poorer people in areas with moderate densities of economic activity. Thus the figure suggests, in a very broad and illustrative way, how as we consider situations with lower rather than greater density of economic activity and people with

lower rather than higher relative household wealth, the financial frontier rises, with a decline in access. Many MFIs have been highly successful in shifting the financial frontier downwards to allow access to formal financial services by households with lower wealth in areas of higher economic density. Our argument here is that successes of MFIs have been achieved by (a) a change in the institutional environment that both permitted NGOs to engage in these activities and enabled them to access soft development finance to on-lend; and (b) new institutional arrangements linking borrowers, groups and micro-finance providers in ways that reduced transaction costs and risks in the provision of external finance to rural people.

Figure 3: **Micro-Finance and the Financial Frontier**



With time micro-finance developments have led to, and been stimulated by, further changes in the institutional environment, in institutional arrangements, and in technology. Changes in the institutional environment have included, for example, new financial regulations bringing micro-finance activities into main stream financial markets, with greater access to commercial finance, greater protection for micro-finance clients, and opportunities for micro-finance organisations to offer a greater range of financial services. New institutional arrangements have been developed as the micro-finance concept has spread to different areas and agencies have developed mechanisms to match the needs of different clients. Changes in technology have involved (at the ‘soft end’) the development of new products and increasing use of new information and communications technologies. The challenge now is to either develop institutional arrangements and financial products that shift the frontier down in (poor rural) areas with lower density of economic activity, or to find other, sustainable, ways of shifting the frontier down, recognising the potential for longer term benefits of such a shift in increasing the density of economic activity, or the possibility of cross subsidisation with wider benefits

This is related to wider processes of economic and population growth and institutional change affecting (among other things) market development, access to markets, and asset accumulation. The ability of people to move from one set of livelihood activities to another also involves ‘exits’ from particular asset portfolios and ‘entries’ to another. Markets may play a key role in allowing such exits and entries on

more rather than less favourable terms. The creative development of non-market institutional arrangements has therefore been a key component in the micro-finance revolution, in conjunction with changes in the institutional environment and in technology.

Turning now to examine the Green Revolution, Dorward *et al.*, 2002 examine irrigated and non-irrigated agricultural transformations in the 20th century and argue that ‘there are certain necessary conditions for intensive cereal based transformations to occur: appropriate and high yielding agricultural technologies; local markets offering stable output prices that provide reasonable returns to investment in ‘improved’ technologies; seasonal finance for purchased inputs; reasonably secure and equitable access to land, with attractive returns for operators (whether tenants or land owners); and infrastructure to support input, output and financial markets.’ (Dorward *et al.*, 2002, p20). The key question is then how these conditions can develop, and they put forward evidence that external (government) action played a role in this in almost every case. With regard to development of finance, input and produce markets, this involved the establishment of specific institutional arrangements, not liberalised competitive markets, in a process summarised in figure 4.

Figure 4 Policy phases to support agricultural transformation in favoured areas⁵

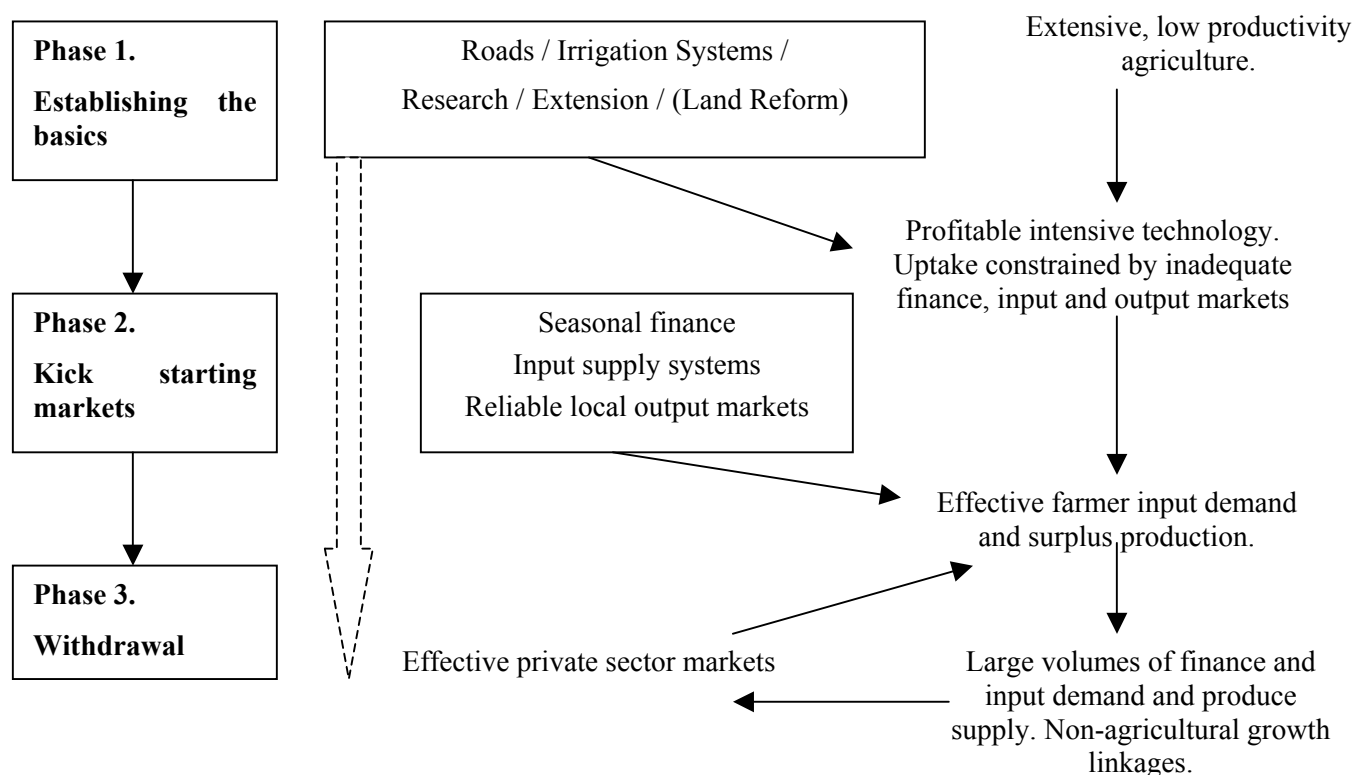


Figure 4 shows schematically how in successful Green Revolutions non market institutional arrangements may have supported financial, input and output market development in a particular development ‘phase’. Thus a prior phase (Phase I) involved basic interventions to establish conditions for productive intensive cereal technologies. Once these were in place uptake was limited to a small number of farmers with access to seasonal finance and markets. Agricultural transformation was then ‘kick started’ by government interventions (in phase 2) to enable farmers to access seasonal finance and seasonal input and output markets at low cost and low risk. Subsidies were required primarily to cover transaction costs, not

⁵ From Dorward *et al.*, 2002

to adjust basic prices. Once farmers became used to the new technologies and when volumes of credit and input demand and of produce supply built up, transaction costs per unit fell, and were also reduced by growing volumes of non-farm activity arising from growth linkages. Governments could (and should) have then withdrawn from these market activities and let the private sector take over (phase 3), transferring attention to supporting conditions to promote development of the non-farm rural economy. Difficulties arose in managing these interventions effectively and efficiently and from political pressures to include price subsidies with transaction cost subsidies and to continue with these market interventions and subsidies when they were no longer necessary (and were indeed harmful). Furthermore, the deadweight costs of such interventions will have been high if they were introduced too early, or continued too long. On the other hand, since their benefits only applied during a critical but short period in the initial transformation, these benefits have been easily overlooked by analysts. This may be one of the causes of their neglect in current conventional policy, which attempts (in our view unrealistically and mistakenly) to move straight from phase 1 to phase 3.

The point we want to make here is not to argue that the same institutional arrangements should be replicated elsewhere, nor that the particular way that the state became involved did not often become ineffective and a monumental waste of resources. The important point that emerges from this is that non-market institutional arrangements played a key role in the Green Revolution⁶. Efforts to promote an agricultural transformation to support improved livelihoods for people living in today's poor rural areas are likely to face much greater difficulties than those that were faced in the successful green revolution areas of the 20th century (Dorward *et al.*, 2002). The need for appropriate institutional arrangements to support agricultural growth is therefore that much greater today.

4 Implications for the Livelihoods Development Agenda

Our analysis of markets and institutions has important implications for the livelihoods development agenda as regards research, analysis, policy and local action.

We need to

- place our understanding of livelihoods and their development in a much more explicit context of dynamic market and institutional change;
- pay much more attention to understanding institutional arrangements and their relationships with the institutional and political environment and with technological change;
- move away from pre-occupation with neo-classical competitive markets;
- look for viable incremental changes that benefit the poor, are 'politically' viable, and are consistent with longer term processes of pro-poor institutional and economic development

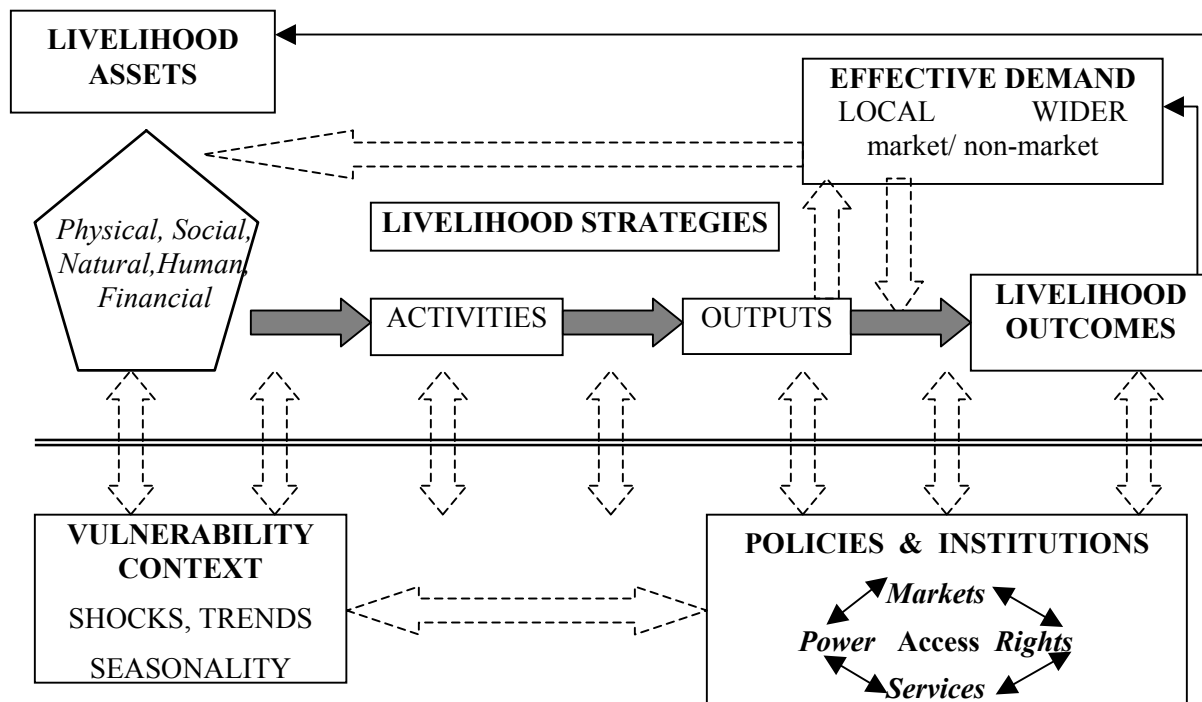
As we have demonstrated with our discussion of the micro-finance and green revolutions, in many ways this is not to suggest anything new, it is rather a call for theory to catch up with practice.

In order to operationalise this agenda, we propose first that these issues should be made much more explicit in 'basic' livelihood thinking. We have suggested elsewhere how this might be incorporated into the goals and principles of formal livelihood approaches (Dorward, 2001b). For many the 'livelihoods approach' is encapsulated by the livelihoods framework (Carney, 1998), and this can be amended to give

⁶ This is not the place to discuss the positive and negative aspects of the Green Revolution, but its use as an illustration is based on a view that it has played a major role in poverty reduction and pro-poor economic growth in Asia, while recognising that it has not solved the problem of poverty and that there are serious questions about its environmental and social impacts (for example see Rosegrant and Hazell 2000 and Lipton and Longhurst, 1989).

more explicit recognition to the importance and roles of markets, institutions and technology in livelihood development (see figure 5).

Figure 5 **Modified Sustainable Livelihoods Framework**⁷



This then has to be translated into identification of possible entry points to promote pro-poor growth. Figure 6 puts forward a conceptualisation that again attempts to integrate the interactions between institutions, markets, technology and the assets and opportunities open to people.

5 Markets and institutions: a case study

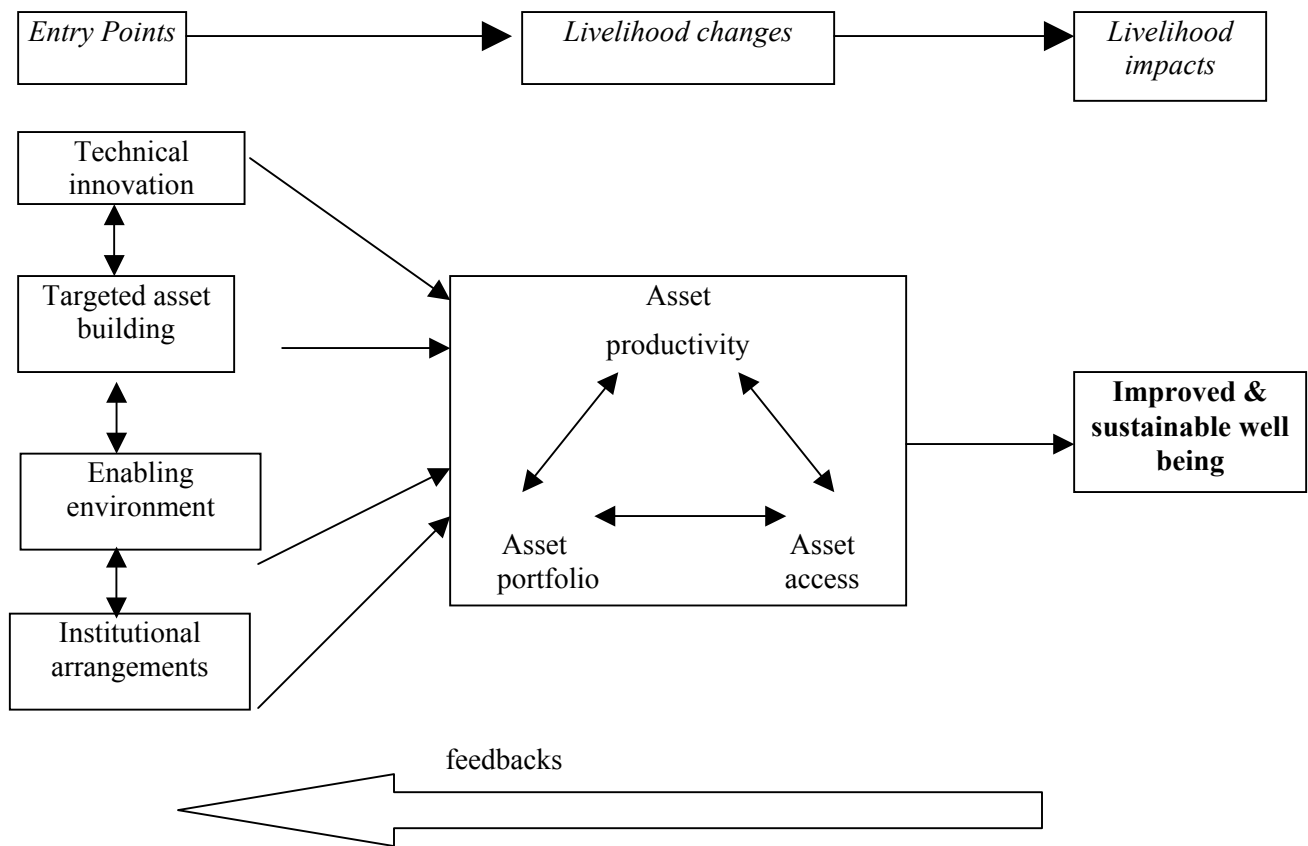
We conclude with brief description of an example of the way that we have recently tried to apply these concepts to a very short desk study of rural livelihoods and agricultural marketing in Africa. We present a summary of this in an annex to this paper and restrict ourselves here to a description of the main elements of our approach.

We began with our analytical framework for examining the roles and performance of markets in the livelihoods of the poor (as summarised in figures 5 and 6 above). This led first to further elaboration of our understanding of the relationships between the broader environment; government policy; government, civil society and private sector organisations; markets; and stakeholder livelihoods (see figure A1.1 in annex 1) and then to a set of questions challenging our understanding of the relationship between the livelihoods of the poor and markets. Understanding which markets are currently and potentially most important for the poor is critical to understanding and thinking about both market and non-market

⁷ From Dorward, 2001b

livelihood interventions. Based on (limited) information available, an attempt was made to identify critical markets for different groups of poor people, and then to identify causes of market failure affecting the access of poor people to these markets. In addition to tentative conclusions about critical market development issues that need to be addressed, the study led to conclusions about the *processes* that need to be followed in formulating a strategy to support marketing and livelihood development. This requires identification of markets that are important for the poor with most potential for improvement, of critical opportunities and constraints for these markets, of the stakeholders involved in these markets. Only then is it possible to consider in more depth how opportunities and constraints may be addressed, to plan and prioritise appropriate action.

Figure 6. **Entry points and livelihood change**



1 Questions for pro-poor analysis of rural livelihoods and markets

- Who are the poor, what are the assets that they hold, what activities are they engaged in, what are their aspirations and livelihood strategies?
- What markets are important for the livelihoods of the poor (or should be important for them) now or in the future, directly or indirectly?
- How well do these markets currently serve the poor, in terms of ease of access, security of access and conditions of access?
- How do these markets fit into supply and value chains? How do these chains operate: where are the constraints, where are the high returns being made?
- What stakeholders are involved in these markets and what are their roles, their interests, their strengths, weaknesses, opportunities and threats (SWOTs)?
- What are the barriers to entry and the transaction costs and risks for different stakeholders?
- What is the institutional environment like and what are its effects on key markets– is it enabling or disabling? How could these be developed or modified to improve market access for the poor?
- What institutional arrangements are currently in place? Why are they in their current form? How could these be developed or modified to improve market access for the poor?
- How are these markets changing and how are they likely to change as a result of wider, external processes of change? What opportunities are there for support to wider process of growth?

This is a complex and challenging set of questions which could rapidly become unmanageable, and analysts need to use the earlier questions to narrow down the range of markets and issues that they focus on. It is also important to have a unifying framework for the examination of the way that particular markets work, and here the widely used concepts of market structure, conduct and performance (SCP) are useful. Figure A1.1 (overleaf) highlights the relationship between the broader environment; government policy; government, civil society and private sector organisations; markets; and stakeholder livelihoods. This framework also helps to structure discussion of recommendations.

2 Initial Application of the Analytical Framework

We began with an initial application of the analytical framework outlined above by considering in some detail the first two questions it poses, and then briefly discussing the remaining questions.

2.1 Who are the poor, and what are their assets, activities and livelihood strategies?

There was little information to hand about the poor in the specific geographical areas that were the focus of the study. We therefore used incomplete information on poverty at both national and area level to construct some ideas on the characteristics of the poor, their assets, their livelihood strategies, and the markets that are most important to them.

Drawing on this limited and disparate information and on more general knowledge of common characteristics of the rural poor elsewhere in rural Africa we developed a set of working hypotheses of the key characteristics of livelihood strategies of the rural poor in these areas:

- Small scale agricultural production by the poor is likely to be concentrated on staple food crop production as this often requires lower financial capital and is not so dependent on wider social networks for purchase of inputs and for sale of produce. Producers are likely to obtain low yields (due to lack of access to purchased inputs and sometimes due to low or late labour inputs) and to sell some produce soon after harvest because of the need to raise cash to pay debts and/or because of poor storage facilities. They may then need to purchase staple foods later in the season when their limited stocks are exhausted. They are

thus both buyers and sellers of staple foods. Sale, storage and consumption of staple foods may involve some processing, particularly of staple root crops. This processing may either pose further costs to the

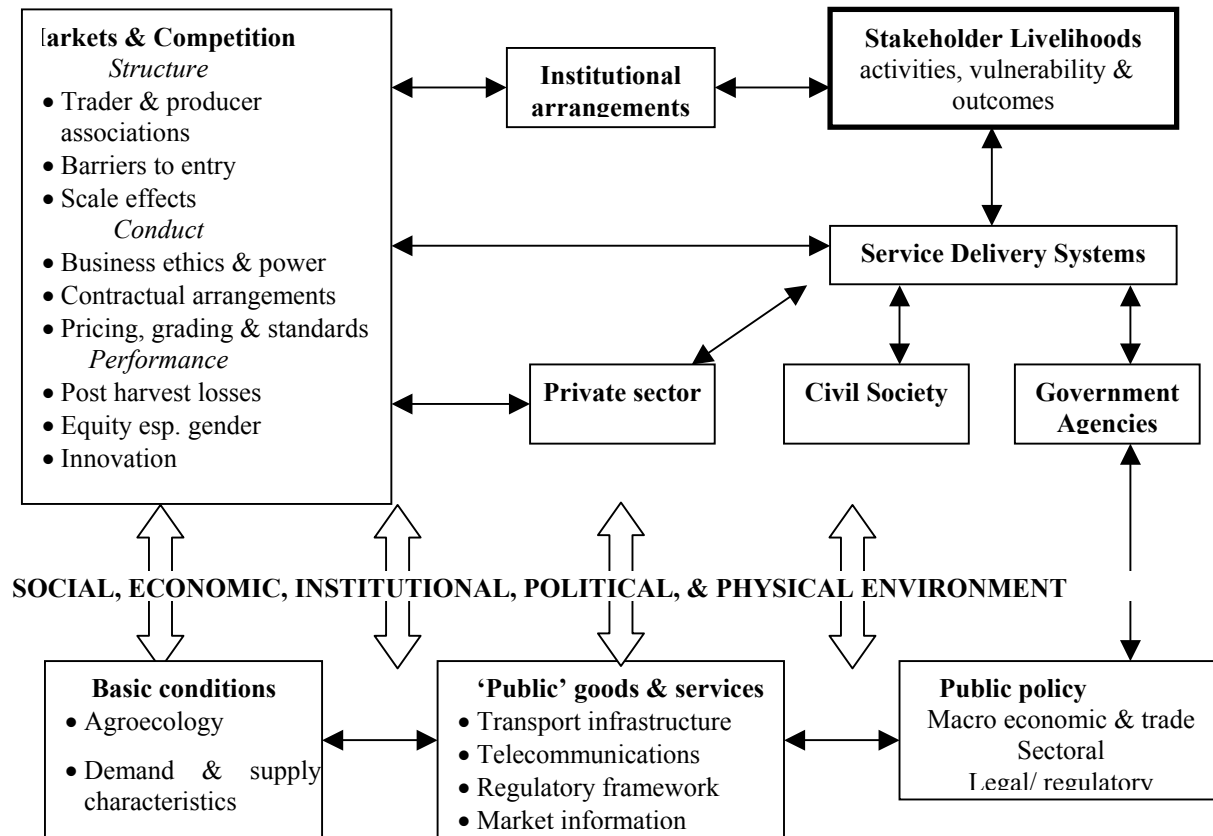


Figure 1 Livelihoods and Market Structures, Conduct and Performance

poor (increasing the margin between sales and purchase prices), or offer income opportunities if they can engage in labour intensive, low cost processing.

- Poor households may also supply casual, agricultural labour to better off farmers. This may be to work on food or cash crops. They may also supply labour to other enterprises owned by better off local people. Where poor households are also cultivating some of their own land, seasonal food or cash shortages may require them to hire labour out to others at the cost of timely labour inputs to their own fields.
- In some areas poor households may rely upon the gathering of wild natural resources for their consumption and for sale. Firewood gathering is a widespread example of this, but wild fruits and fibres may also be important.⁸
- The supply of low skill, low investment services in the local economy is another common income generating activity of the rural poor. Examples of such services may be petty trading, simple food processing such as cooking snacks or brewing, water carrying, local transport (porterage), etc.
- The poor may also rely upon seasonal or long term migrant labour, outside their local communities in urban areas or in other rural areas. Closely associated with this is the importance of remittances from migrant family members working in these areas.

⁸ Pastoralists constituted a distinct subset within this group, but we had insufficient information on the numbers of pastoralists in the areas or on their livelihoods to explicitly consider them further.

2.2 *What markets are important for the livelihoods of the poor?*

Using this stylised identification of the livelihood strategies of the poor, we then suggested markets that may be important for their livelihoods, both directly and indirectly, and allowing for both current and potential importance. For agricultural producers, key assets and inputs were identified as land, labour, seasonal inputs (such as seed and fertilisers), and seasonal capital (such as food stocks and cash for domestic consumption and for inputs). Staple food markets were important to poor producers in terms of the farm gate prices at or shortly after harvest, and in terms of prices paid as consumers at other times of the year. Consumer prices for staple foods are important to all the poor, for whom staple food expenditures account for a large proportion of total expenditures and incomes. Wages received for agricultural and non-agricultural employment depend upon the workings of labour markets, and upon the demands for labour. Agricultural labour demand depends largely upon output prices, for both staple and cash crops, and upon labour productivity, determined by technology and larger farmers' investments in seasonal and longer term capital. Non-agricultural labour demand depends largely upon local incomes and demands for local goods and services.

Table A1. Markets impacting upon the rural poor

| Livelihood Strategies | Markets with direct impacts <i>Italics indicate potentially important markets not widely accessed at present</i> | Markets with indirect impacts |
|------------------------------|---|--|
| Poor agricultural producers | Staple food sales Staple food purchases Agricultural inputs <i>Seasonal finance and savings</i> Land | (1) Wider national and international markets for crops, inputs, transport and finance, and their interaction at different points in market chains. Local competitors' access to these other markets. |
| Poor agricultural processors | Staple food sales Staple food purchases <i>Processing inputs & equipment</i> <i>Financial services</i> | (2) Wider markets (see (1) above). (3) Wider financial markets. |
| Agricultural labourers | Labour Staple food purchases <i>Financial services</i> | (4) Commercial farms' access to markets for cash & food crops (for labour demanding crops), inputs, finance and land. Wider markets (see (1) above). (5) Wider markets (see (1) above). (6) Wider financial markets. |
| Non-agricultural labourers | Labour Staple food purchases <i>Financial services</i> | (7) Local markets for non-agricultural goods and services, employers' access to finance and input markets. Wider markets (see (1) above). (8) Wider markets (see (1) above). (9) Wider financial markets. |
| Petty trade, services, etc. | Local goods & services Production inputs (raw foods, processing equipment, etc) Staple food purchases Micro-finance / financial services | (10) Local labour markets (11) Wider markets (see (1) above). (11) Wider markets (see (1) above). (12) Wider financial markets. |
| Migrant labour & remittances | Migrant labour markets <i>Money transfer, & other financial services</i> | (13) Wider urban, rural & cash crops markets (see (1) above). (14) Wider financial markets |

Table A1 presents a summary of the markets expected to have direct and indirect impacts on different livelihood strategies. It sets out hypotheses for testing as regards predominant livelihood strategies in specific areas ⁹, and suggests markets whose functioning is directly or indirectly important to the poor.

⁹ For example we hypothesised that agricultural products (food and cash crops) were the major locally produced tradables; that increased local incomes would lead to increased demand for locally produced, non-

We also considered how, as a rural economy develops, the relative importance of different markets might change. This led to consideration of how specific markets might be identified for initial attention in different areas.

2.3 Further questions

The analytical framework developed above then posed further questions about the nature of the markets that are important to the poor, the way that the poor are currently served by them, their structure, the different stakeholders in these markets, their institutions, and their dynamics. Three general issues were raised: first, that the way that these questions should be addressed varies between markets that are of direct and indirect importance to the poor; second, that an analysis of stakeholder interests in these markets might reveal that, although widely denigrated, non-competitive restrictive practices of trade associations and cartels need very careful examination, as middlemen often perform useful market functions and in doing so often engage in substantial risks¹⁰; third, that it is essential to ground all analysis in an understanding of the broad institutional environment (for example trade and macro-economic policies and conditions, business and government practices, governance) and of specific institutional arrangements whereby buyers and sellers make contact and agree, conduct and enforce transactions. Such understanding must recognise the reasons (market and non-market costs, returns and risks; social and cultural factors) for particular agents adopting particular practices. Three other broad interlinked themes were also addressed with regard to trade and macro-economic policy (a) the macroeconomic environment, (b) agricultural and trade policy, and (c) governance. For each of these it was necessary to consider differential impacts on food and export production.

3 Recommendations

Recommendations on moving forward addressed both the process of developing a marketing programme, and the focus, aims and content of such a programme.

3.1 The process of developing a marketing programme

In developing our analytical framework, we developed and began to work through a set of steps necessary for developing a programme to address marketing constraints and opportunities facing the poor.

- Identify which markets are important for the poor with most potential for improvement
- For these markets identify critical opportunities and constraints.
- Assess how these may be addressed, and the stakeholders involved
- Relate these to stakeholders' resources, objectives and existing activities
- Prioritise issues for potential actions, identify actions, identify further information and stakeholder consultation needed.

This process should take account of

tradable goods and services; and that this would increase demand for hired or self-employed labour, providing the major pathway for increasing incomes for the rural poor.

¹⁰ While grossly inequitable returns between traders and farmers and corrupt and violent means to maintain market positions must be condemned and attacked, such action must recognise (a) the power of these associations, (b) the value of the services they provide, and (c) the skills, difficulties and risks which are involved in providing these services. The latter often prevent poor farmers and farmer associations from providing these services themselves and also require high returns for traders and protection from competitive risks if they are to provide these services for an acceptable profit (Smith, H.M. and Luttrell, 1994).

- The need to consider issues in different sectors, and the varying interests and responsibilities of different national and local government agencies, and of NGOs and private sector agents in those sectors (important sectors here were identified as including transport, telecomms, governance, finance, and broader trade and macro- policy, in addition to agriculture);
- Different types of action and roles that external parties may take (for example advocacy, technical assistance, investment, and coordination), and the different roles, resources and constraints of government (federal, state and local authorities and parastatals), civil society, private sector and donor agencies and of course of the different groups among the rural poor themselves.
- The importance of partnership and participation by different stakeholders in this process.

3.2 *Marketing constraints and recommendations*

Limited reports on agricultural marketing in the study areas identified a range of constraints to improve producer output marketing with broad similarities across different areas. These included problems with roads, market information, standardisation and grades, market facilities, market regulations, processing, storage, finance, and restrictive and exploitative practices by middlemen and market managers. The list of common constraints to marketing was all-encompassing but typical of many developing economies.

We recommended that feasible solutions for overcoming the marketing constraints should be sought primarily through increasing the involvement of the private sector (private firms and intermediary/trade associations) as well as working through central and local government and other structures within the civil society (CBOs, NGOs). We recommended an indirect approach to reducing the constraints by tackling the underlying causes of market imperfection and failure and suggested appropriate partners as entry points, expected actions or outputs. Table A2 overleaf presents recommendations applying to a greater or lesser extent to different agricultural markets, but these recommendations needed prioritization and targeting to suit particular markets, local conditions, and the concerns of local communities and other stakeholders, in accordance with the processes and principles outlined earlier.

We grouped the marketing constraints identified above into a set of principal causes of market imperfection and failure as follows:

- **Physical access** is of considerable importance, and poor roads and other infrastructure raise marketing costs of transport inputs and products, increase post-harvest losses, and create a rationale for high margins. There is a need for advocacy, coordination and facilitation among donors and local and central government actions in this sector, addressing both major road infrastructure and feeder roads. The latter take on more of a community- or private good characteristic and need not be funded solely by Government out of a necessarily limited budget. Responsibility for such roads and local efforts to improve them could be sought through partnerships with local civil society (NGOs and CBOs). Private transport services should respond to improved road conditions and increased demand.
- **Information** (like many of the issues raised) is a complex issue both in respect of its kind, collection and delivery (Poole *et al.*, 2000a; Poole *et al.*, 2000b). Information has both public and private good characteristics, and some of the problems of access to reliable and relevant information will be met through improved telecommunications. It is here above all that the interests of the private sector firms to extend operations into rural areas can help to overcome informational imperfections and increase the competitiveness of the trading system (Lynch *et al.*, 2001 Poole, 2001) – notwithstanding the much wider social and civil benefits that will accrue from better access to telephones. Government agencies and the telecomms sector need to establish and implement policies whereby telecommunications can be rolled out into rural areas in such a way as to alleviate, not exacerbate, poverty. External agencies may have an important role in supporting this, as both technology and institutional innovations (such as private/ public partnerships and community participation) are needed. Experience is limited in this area, but the current commercial environment and the rate of technological change offer both opportunities and threats for poverty alleviation. Private sources of investment are likely to be attracted into this area.

Table A2. Principal Causes of Market Failure and Possible Donor Entry Points

| Principal causes of market imperfection and failure | | Partners | Actions/ outputs | Donor role |
|---|---|--|---|---|
| Poor physical access | Poor roads and physical infrastructure Weak transport systems | Government (central, regional, local) Civil society (CBOs) | Road construction & maintenance (trunk, feeder) Institutional innovation (e.g. participation & financing systems), technology | Technical assistance Finance Coordination of government and CBOs |
| Poor informational access | Lack of communications | Government (central, regional) Private sector firms | Telecomm networks, village phones, local radio, institutional innovations | Technical assistance Coordination of government and private sector firms |
| Inappropriate regulatory framework | Over-licensing | Government (regional, local) | Clear and enforced, minimal regulations | Technical assistance for deregulation |
| Poor market organisation* | Competitive local market structures Local market systems Linkages between small and medium/ large-scale firm sectors | Government (regional, local) Civil society (NGOs, Trader associations, CBOs) Private sector firms | Transparency, empowerment, information, incentives, regulation, effective governance | Technical assistance Coordination of government, civil society and private sector firms |
| | Lack of utilities & 'public goods' (Power, Water) | Government (central, regional, local) | Infrastructural investment, financial management & control, maintenance systems, SMEs | Technical assistance & coordination for privatisation & government & private sector investment |
| | Physical infrastructure & services Market places SME trading/shop places | Government (local) Civil society (Trader associations, CBOs) | Infrastructural investment, financial management & control, maintenance systems, SME promotion, reduced market losses, health and sanitation improved | Coordination of government & civil society |
| Inadequate finance* | Inadequate credit and savings systems for traders, processors, producers, & consumers; lack of effective demand for production inputs | Government (central, regional, local) Civil society (Trader associations, CBOs) Private sector firms | Institutional innovation (e.g. financial systems) for indirect provision of inputs and technology to end users through market intermediaries. | Technical assistance & coordination for government, civil society and private sector intermediaries |
| Weak business skills | Weak entrepreneurship | Government (regional, local) Civil society (NGOs) | Capacity building | Technical assistance Finance Coordination of government and civil society organisations |
| Unpredictable macro economic and trade conditions | Ad hoc & rent seeking policies Bias to cash rather than food crops Over-reliance on oil exports | Government (central, central bank) | Transparent, accountable & consistent policy making & implementation | Advocacy Technical assistance |

- There was evidence of the small business sector suffering from **over-regulation** that imposes high costs on entrepreneurship and prevents start-ups and business growth. This element of the regulatory framework needs to be studied, leading, if necessary to deregulation or re-regulation in a more business-friendly way. While sound regulation serves an important quality control function, and generates revenues, its purpose should be to promote rather than limit entrepreneurship.
- We perceived three ways in which **market organisation** was weak:
 1. competition within and linkages to the wider economy (for example the non-competitive practices of trader associations);
 2. provision of utilities which are normally considered to be ‘public goods’
 3. provision of local marketplace infrastructure, which is normally considered to be a ‘public good’, and trading space.

Some of the **competitiveness issues** could be addressed by improved business skills, by promoting alternative (and competing) market channels, and by reducing over-regulation. Other ways to mitigate the inevitable inequities in market power included the development and implementation of customary (traditional) and modern contract law. Contracts may serve to enhance business attitudes and ethics, and reduce transaction costs (Poole *et al.*, 2000c). Public market information systems could also have a limited but real function in improving competitiveness. This is a difficult area that needs more attention.

Questions also arise in the provision of ‘public good’ **utilities** of power and water that make small-scale agro-industry possible, and that create a healthy and congenial trading environment particularly in traditional market places. These needed to be tackled initially in government. Privatisation policies may lead to the introduction of private sector involvement and coordination is needed between donors and government approaches to removing these constraints.

Finally, the need for physical infrastructure in **market places** needed to be tackled at local government level, together with the participation of civil organisations such as CBOs and trader organisations. The collection of local market fees suggested the potential for government resources to be invested in appropriate infrastructure. Local governments should be in a position to ensure that spatial planning and land use takes account of the need for small-scale industrial development and environmental concerns.

- **Finance** is always a constraint to input and output marketing activities, and financial assets of the poorest are the most difficult to address. Government at all levels have a role to play that needs to draw on expertise available to donors and development organisations. Facilitating finance to intermediary agencies – private firms, CBOs, traders and associations - is an important strategy in its own right to increase scale and scope of business enterprise, and upgrade technology. Facilitating finance to intermediary agencies also can improve the delivery of inputs to farmers and introduce liquidity into output marketing. Moreover, delivery of credit can be linked to savings, the other important element in rural finance. Interlocking input, output and finance markets may be a key strategy (Dorward *et al.*, 1998). Our view is that there is currently no workable sustainable mechanism for the direct delivery of seasonal finance to smallholders (Dorward *et al.*, 2001). However, finance can sometimes be delivered successfully to smallholders – at a cost – through intermediate agencies such as traders, and there is scope for imaginative institutional innovations here (such as, for example, the CARE-Agent model in Zimbabwe, Rusike *et al.*, 2000).
- **Business skills**: Because farmers often have to await buyers’ visits, because of lower levels of educational attainment, and possibly because of intimidation at market places, entrepreneurial skills are expected to be relatively undeveloped among many farmers. We did not envisage direct interventions to bring about better grading and standardisation of products, but more emphasis on consumer satisfaction, quality control and safety of food products. This could be encouraged by better coordination of efforts to channel expertise in business skills through universities, technical institutes, NGOs and school curricula. Developing appropriate teaching materials and delivering them through various channels is not a complex task, and could lead to long term improvements in trading and serve somewhat to redress the imbalance in economic power between smallholder sellers and trader buyers.
- **Macro-economic and trade conditions**: It had been noted that private sector activity and in particular food crop production (and marketing) were inhibited by the unpredictable macro-economic and policy

environment. A major task facing the government, and one needing substantial donor support, is to promote transparent, accountable and consistent policy making processes that support rather than inhibit more equitable private sector investment in productive and trading activities.

These recommendations were by necessity often very general, but provided a context for further investigation and for the process of developing a programme to take forward attempts to promote markets supporting pro-poor livelihood development.

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