



“Making markets work for the poor” as a core objective for governments and development agencies

David Elliott and Alan Gibson
The Springfield Centre for Business in Development, UK

February 2004

*PostNet Suite 598
Private Bag X29
Gallo Manor 2052
South Africa*

*Tel +27 11 802 0785
Fax + 27 11 802 0798*

Making Commodity and Service Markets work for the Poor in Southern Africa

Contents

Executive Summary

1. Introduction	1
1.1 Background	1
1.2 Objectives and structure.....	1
1.3 The poverty reality	2
2. Markets are important: the significance of market development for poverty reduction.....	4
2.1 Factors that reduce poverty.....	6
2.2 Systems: the underlying causes.....	7
2.3 Markets within systems	12
2.4 From market development to poverty reduction	16
3. Markets are complex: understanding key debates and characteristics of markets and the poor	18
3.1 Markets and morality	18
3.2 Winners and losers.....	19
3.3 Market imperfections	21
3.4 The dynamic nature of markets	22
3.5 Roles of key players	23
4. MMW4P analysis and actions	25
4.1 Delineating the market.....	25
4.2 Understanding markets currently.....	26
4.3 How do we envisage markets working more effectively in the future?	28
4.4 Building from analysis to actions	34
5. Conclusion	35

Annex 1: Conceptual issues in understanding markets

References

Executive Summary

Reducing poverty continues to be the foremost priority and challenge for governments and development agencies. In considering how to do this, markets are considered to be important yet there exists considerable confusion over the relationship between the poor and markets. While, for some, markets are commonly seen as a threat, more successful approaches to poverty reduction appear to have been based around market development; ie to have made markets work effectively for the poor.

This paper emerges from this context. It is about *why* making markets work for the poor (MMW4P) is important and should be a priority and, given this, *how* organisations can begin to make sense of this in their own work.

Markets are important

The rationale for market development for the poor as a core objective of governments and development agencies is based around three connected arguments:

1. Successful poverty-reducing environments are characterised by robust economic growth plus a range of related, specific services and amenities. Growth, however, is critical and is *the* key driver of poverty reduction.
2. The disparate performance of countries (in delivering poverty-reducing environments) is attributable to underlying systemic causes. Mixed development experience has prompted considerable re-thinking on *what is important* in shaping development performance and, in particular, brought a focus on core systemic issues - formal and informal rules, information and physical realities.
3. Markets contribute to and are shaped by the wider systems of which they are a part. Systems that are more pro-poor in their final outcomes have understood, captured and utilised the essence of markets; ie they have made markets work for the poor.

Tangible evidence of the pro-poor benefits of tapping into and developing markets comes from different contexts. In markets as different as financial services, water, labour, land, agriculture, telecom and manufactured goods (and in every major continent), there are many instances of substantial, discernible improvements in the poor's access to markets generated through specific actions. Better market access can be related directly or indirectly to reductions in poverty.

Successful approaches to MMW4P, although varying considerably, are all based around identifying and addressing the underlying systemic constraints that prevent the poor's access – for example, distortive regulations, poor information, dysfunctional informal networks, weak industry linkages and products, and inappropriate government delivery roles. Moreover, by focusing on underlying causes (systems) rather than symptoms, the scale of impact achievable through focused actions is considerable – and much more than is achieved “conventional” responses by governments and development agencies.

So, while the precise route from market development to poverty reduction varies, in each case improved *access* for the poor (either as consumers, producers or employees) results in improved *benefits* (such as welfare gains, productivity, investment, higher income and better networks) and stems from a range of change *triggers*. Change can be initiated by a variety of factors but in all cases aimed at addressing specific, identified constraints.

MMW4P analysis and actions

How to identify and act upon opportunities for change – turning the potential of markets to reduce poverty into practical actions - is the key challenge before governments and development agencies.

While there is no convenient and precise formula for operationalising MMW4P, making sense of it does involve a number of general steps. Critically, these all require a considered and nuanced view of how markets work in practice, and in particular of:

- The moral case for market development built around clear and diverse benefits but cognisant of the limitations of markets
- The multi-function nature of markets: for markets to develop in an innovative and dynamic manner, a range of different functions – beyond the core market transaction – need to be undertaken including product development, regulation and information.
- The potential roles of key players in relation to these functions such as the private sector, government, representative organisations and nor-for-profit agencies.

Building on this understanding, organisations seeking to take a commitment to MMW4P into their own situations need to consider four general steps.

1. Delineating a market: markets can be defined with respect to factors of production, commodity or product, business service or geographic area.
2. Understanding markets currently: this includes consideration of four key questions :
 - (a) What are the wider influences on and prospects of the market?
 - (b) Where are the poor in markets: what is the current level of market participation?
 - (c) What is the existing structure in terms of key functions and players?
 - (d) What are the current (systemic) factors impinging on the market?

Answers to these questions provide an in-depth and informed view of the existing situation in a market and – critically – of the key constraints that are preventing enhanced participation of the poor; ie of why the market is not working for the poor.

3. How is it envisaged that markets will work more effectively in the future? This involves considering what should be the role of different players in relation to market functions (who does and who pays?) and why should they play these roles. A transparent and shared view of the future offers the basis for collaboration and development. At the heart of this, organisations need to consider their own core competence and capacity, and that of others.

In particular, in considering their role, governments – always a key player - should be aware of the broad range of different options before them, many of which offer potential for new and productive relationships with the private sector and of far-reaching sustainable impact. An increasing number of practical examples illustrate the dramatic and positive changes possible from different government roles rather than from simply replication of past or existing practice.
4. Building from analysis to actions: having built a picture of both the current situation (of *where we are*) in a market and of the future vision (*where we want to go*), the focus of actions immediately is on *how to get there*?

MMW4P therefore offers a clear direction and opportunity for both governments and development agencies to pursue a path of development that, building on a range of experiences, brings tangible and sustainable impact.

1. Introduction

1.1 Background

High levels of poverty is the foremost indicator of underdevelopment and injustice globally. While poverty has reduced substantially in some regions, in others, especially Africa, it continues to be significant and is actually growing in absolute terms. Reducing poverty remains the first priority and challenge of governments and development agencies.

In considering how do to this, markets are accepted to be important. Poor people exist within markets – as consumers or producers. “Market-friendly” macro-economic reform has been the focus of development in recent years – but often with limited success. Moreover, the precise relationship between the poor and markets is not clear and the role of key players, governments and development agencies, with respect to markets and poverty is similarly confused. Indeed, for some, markets are commonly seen as a threat to the poor. Meanwhile, more successful approaches to poverty reduction often appear to have been based around market development. These experiences have led to increasing attention now on how to make markets work more effectively for the poor.

This paper emerges from this context. Its aim is to establish making markets work for the poor (MMW4P) as a core objective for government and development agencies and, from this, to offer guidance on the implications of this commitment for policies and actions. It is about *why* market development for the poor is important and, given this, *how* organisations can begin to make sense of this in their own work.

1.2 Objectives and structure

The paper therefore has two specific objectives:

To establish the rationale for and importance of MMW4P as a critical focus of development policy and actions

To outline broadly some key implications of this for the analysis, approach and actions of development agencies and governments to wards MMW4P.

In pursuing these objectives, the paper is structured in the following way. Building on a summary of current poverty trends, section 2 outlines the rationale for MMW4P as a development objective. It summarises the flow of logic that links poverty reduction to markets. Key characteristics of poverty-reducing environments are identified as a function of core, underpinning systems within which poor people exist. At the heart of systems are markets that, as shown through different examples, can act positively or negatively in relation to the poor.

The remainder of the paper deals with how organisations can take this objective into their own working contexts. In order to do so, key debates and characteristics associated with markets first need to be recognised and these are summarised in section 3, including markets and morality, market imperfections, market functions and the role of key players. This sets up section 4 dealing with broad steps that organisations can take to turn MMW4P into useful actions.

The paper is aimed at a broad audience including senior personnel in governments, donors, corporate donors and not-for-profit agencies and associated advisers and researchers for whom poverty reduction is a priority objective. As well as those engaged directly in economic and private sector development, it aims to be relevant to staff in other spheres such as agriculture, governance, health and education. While primarily focused on Africa, its content and message has broader relevance.

Finally, as important as it is in understanding what this paper is, is being clear about what it is not.

- Not a “how to” manual – this is an introduction only. While being a stand-alone document it aims to contribute to a larger process of reflection and change.
- Not a textbook – the paper seeks to be rigorous but inclusive, valid intellectually but accessible to a broad range of stakeholders^a.
- Not postulating a new model – it builds on experience, cases and emerging theoretical thinking to present its arguments.
- Not all-encompassing – it does not “cover” all aspects of a vast subject area.

1.3 The poverty reality

The persistence of poverty sets the scene for this paper and defines the challenge of MMW4P. For some organisations, poverty reduction stems from a clear moral imperative. For others, the prime motivation is broader; recognition that societies which do not address poverty and gross inequality are unlikely to be stable or prosperous. Whether arising from moral concerns or enlightened self-interest, poverty reduction is an objective at the heart of economies and societies.

Poverty is – at its core – about incomes, but it is also about the wide set of characteristics often associated with lack of income. It is related to assets and income-earning opportunities; to consumption; to nutritional and health status and access to appropriate services; to learning and educational opportunities; to wider political freedoms and rights; to people’s ability to deal with shocks and insecurity; and to their status and sense of dignity¹. This diversity of poverty’s symptoms means that it does not lend itself to neat definition. However, from the above, it is clear that poverty is concerned with people’s:

- *condition* – their (low) economic, health, educational and social status
- *capacities* – their ability to “do something about” these problems
- *opportunities* – the scope offered to people to address these issues.

Solutions to poverty – including MMW4P – must therefore generate opportunities for poor people and assist them to develop their capacity to respond to these.

Figures 1 and 2² provide an overview of poverty trends with respect to two widely-accepted indicators: the proportion of the population living on less than a dollar per day – the most common international “headline” poverty indicator - and the human development index – the most used composite indicator that reflects income and non-income elements^b. From these, three conclusions emerge:

- Poverty is still all-pervasive – 1.1bn exist in the most dire conditions. Indeed, a slightly looser definition (of \$2 per day) increases that number to 2.7bn.
- and poverty is especially persistent in Africa – while the overall incidence is broadly static (or declining marginally for some indicators), the absolute numbers of people in poverty is growing in Africa.
- but poverty is reducing significantly in places – in Asia in particular, the incidence and actual numbers of people in poverty has reduced dramatically (and for discernible reasons).

^a The working assumption is that readers are economically literate without necessarily being economists!

^b Calculated on the basis of life expectancy, literacy and GDP per capita data.

The poverty reality confronting development organisations is, therefore, daunting - but optimistic. While the scale of poverty is immense and its centrality to countries' development is clear, it is neither inevitable nor beyond solution. There is a growing body of experience of how to address poverty successfully which has the development of markets at its core; this paper emerges directly from learning derived from this experience.

Figure 1: Poverty Trends
Population living on less than \$1 per day

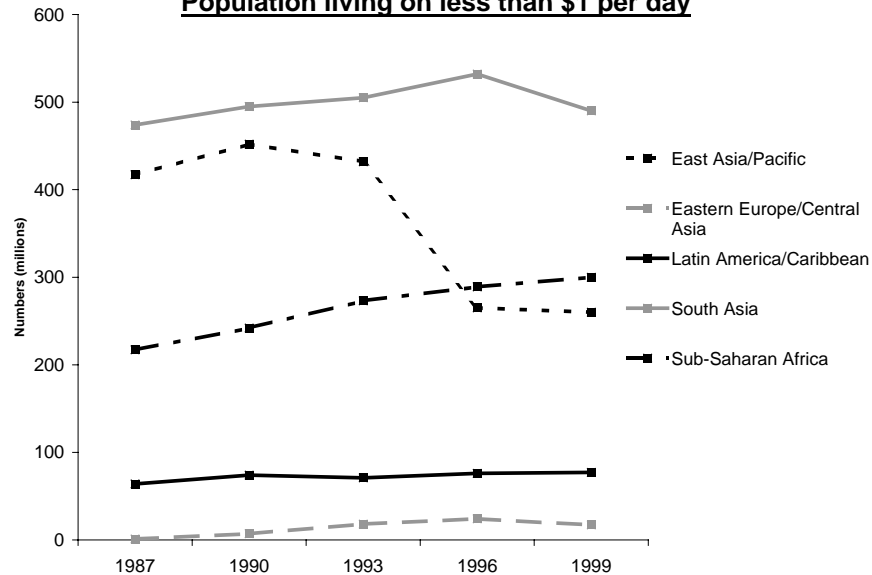
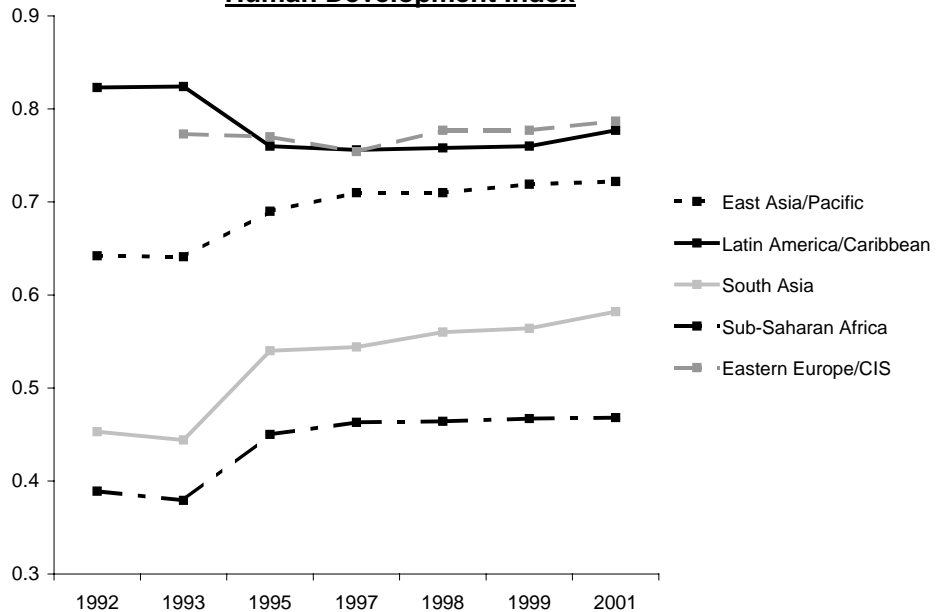


Figure 2: Poverty Trends
Human Development Index



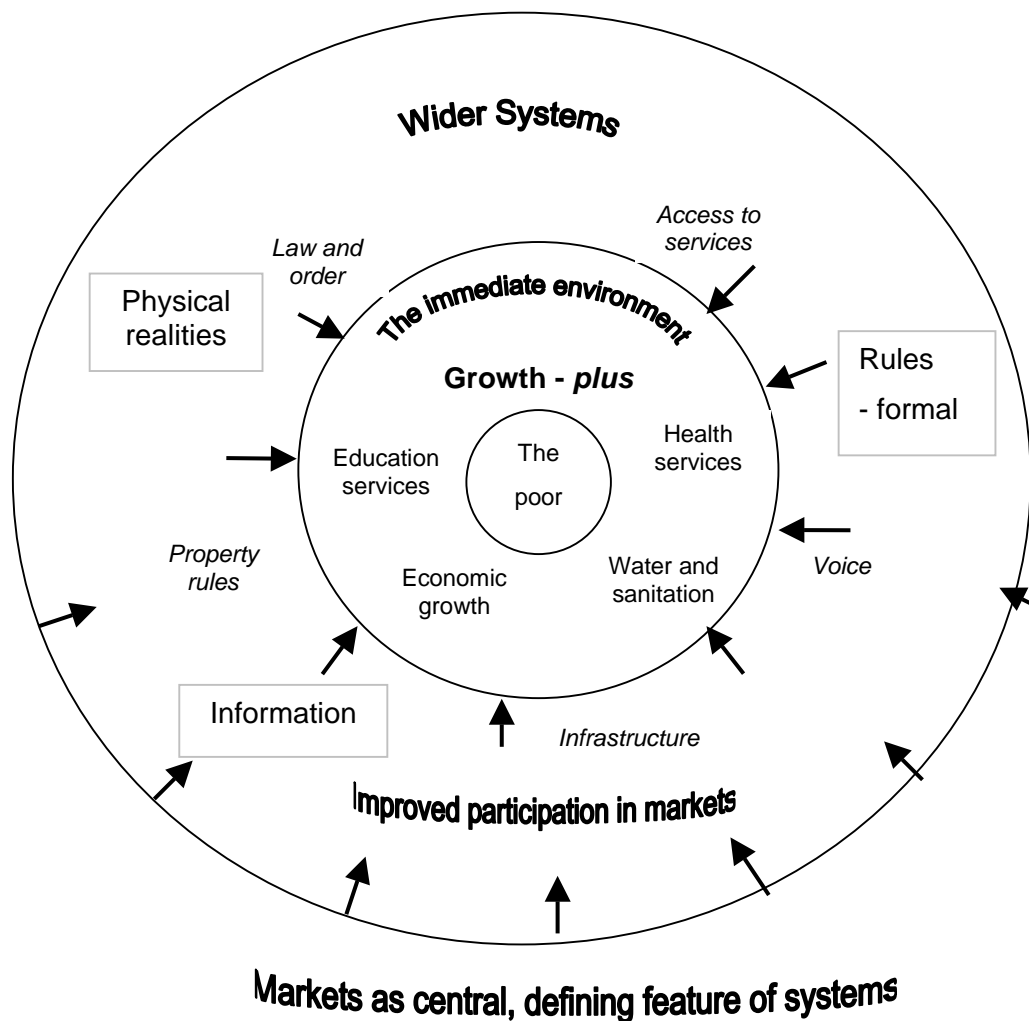
2. Markets are important: the significance of market development for poverty reduction

Given the reality of poverty – and its priority for government and development agencies – what is the rationale for MMW4P to be a core objective for them? Why is it that MMW4P is so critical for poverty reduction? What links a commitment to poverty reduction to a specific objective of MMW4P?

In addressing these points – to connect poverty with markets – it is necessary to consider the “big” issue of why people are poor, to examine the underlying systemic reasons for poverty. This section sets out this core rationale for market development as a key focus in poverty reduction by providing three links (Figure 3) in the flow of logic that connects poverty with markets:

1. the immediate factors that reduce poverty;
2. the systemic causes of poverty; and
3. evidence that demonstrates how market development can address these causes.

Figure 3: Making markets work for the poor: the path from markets to poverty reduction



2.1 Factors that reduce poverty

People are poor because their immediate world – their environment – does not allow them to rise from poverty. Their world is characterised by lack of opportunities; one that does not give people much *chance* for development. Poverty reduction, logically, takes place most effectively in environments that offer this chance – that deliver a number of key outputs that allow poor people to “get what they need” in order to earn income, build assets, learn, be healthy, and deal with shocks and the many other facets of the poverty condition.

The most important feature in an environment that is conducive to poverty reduction is economic growth. While some have pondered on the necessity of growth, more commonly, questions have arisen over its direct benefits for poor people. However, evidence of growth’s importance is overwhelming. Table 1 shows the close correlation between growth and poverty reduction in the 1990s, most notably in East Asia. There is no evidence to indicate that the poor miss out because of growth³. On the contrary, in general, the poor gain as much as the rest of the population from growth - or even benefit disproportionately. The precise relationship between positive per capita GDP growth and reduction in poverty headcount (the elasticity of poverty to average income) varies depending on a number of factors (estimates typically vary from 0.5 to 1.0) but growth’s importance is clear⁴.

Table 1: The links between growth and income poverty in the 1990s

Region	Growth (annual per capita) (%)	Change in proportion of people living on less than \$1 per day (%)
East Asia and the Pacific	6.4	14.9
South Asia	3.3	8.4
Latin America and the Caribbean	1.6	-0.1
Sub-Saharan Africa	-0.4	-1.5
Central and eastern Europe and CIS	-1.9	-3.5

Growth emerges *by far* as the most significant factor in a poverty-reducing environment. Indeed, it has been argued that the additional income generated (for individuals and governments) by growth feeds through into other dimensions of poverty and consequently growth so outweighs any other consideration that governments should only focus on this⁵. More commonly, it is argued that the pattern and quality of growth are also significant in determining the extent of its pro-poor virtue. Growth - especially if one looks beyond income-based poverty measures - is a necessary but not sufficient condition. There are many examples of differential poverty impacts from apparently the same growth performance. The Indian state of Kerala has an infant mortality rate one-quarter that of the national average yet with similar growth performance⁶.

Significant poverty reduction therefore requires growth *plus*. Poverty can only improve markedly when a range of different services and amenities (such as health, education, water and sanitation, law and order and environmental services) are delivered effectively to address poverty's wider, non-income reaches. Moreover, these "plus factors" contribute to and benefit from growth. For example, a more educated labour force allows firms to compete in higher value-added markets, in turn generating more resources and incentives for improved services such as immunisation rates and school enrolment figures. But while these may all be influenced by growth they are not simply a function of it. For example, there is no formulaic relationship between public spending on services and outcomes and there are many examples of additional resources *not* succeeding in delivering effectively for poor people, either being used inefficiently and/or accruing to wealthier groups⁷.

So, people have greatest opportunity to rise from poverty when their immediate environment is one characterised by robust economic growth plus a range of related, specific services and amenities. How to achieve such an environment is the key challenge.

2.2 Systems: the underlying causes

If the broad range of factors that are required in order to reduce poverty are known, why then are some countries more effective than others in addressing poverty? What is it that accounts for the disparate performance of countries – with some succeeding and others, palpably, not?

The reasons here lie in underlying systemic and structural factors – the systems within which poor people exist – that shape countries' performance in delivering a poverty reducing environment. The need to focus on systems emerges from the wider experience of development in *practice*, especially in the 1980s and 1990s, and, accompanying this, a re-thinking in economic *theory* related to development.

First, the general development experience of only partial success (and of dramatic failure in many countries) has taken place when there has been a relatively clear view on the policy stance that countries *should* adopt. Years of largely disappointing results produced by state-led development provided the backdrop to a fresh

approach to development in the 1980s. The key tenets of this “market-friendly” approach were relatively straight-forward: fiscal discipline, low marginal taxes and a broader tax base, competent delivery of key basic services, openness to trade and investment, liberalising microeconomic reform and privatisation of state enterprises. And while there has never been complete unanimity of view on all aspects of this, the so-called Washington Consensus has been at the heart of the policy prescription advocated by most development agencies and pursued by most governments in the 1980s and 1990s.

Yet with vastly different results. Supply-side response has often been weak and the hoped-for surge in growth stimulated by the newly-created economic environment failed to materialise. To some extent, especially in Africa, the development experience has been one of considerable failure⁸.

Why has this happened? Various reasons are cited. The extent of corruption has often been underestimated; reforms in Russia, especially privatisation, were introduced without adequate controls or understanding of prevailing norms and resulted in larceny of state resources on a grand scale. In Malaysia, financial gains from privatisation of the power sector went mainly to members of the ruling party. Poor infrastructure prevented African farmers from taking advantage of new opportunities. Inadequate prudential regulation of banks undermined financial reforms in Asia and contributed to the Asian crisis of the late-1990s. Weak government capacity prevented appropriate regulation and management of new arrangements with private providers.

Many of these factors are highly context specific and drawing general lessons from them has proved elusive. The perception of considerable development failure has prompted widespread, if often rather unfocused criticism of structural adjustment and the range of policy prescriptions with which it is associated. Sometimes wrapped up further in general discontent over globalisation (and of markets generally) these are regarded as an imposition of unfair and wrong approaches by distant technocrats. A number of points are clear from this general experience.

- The policy prescriptions emerging from the Washington Consensus are, in themselves, *not enough*. As a framework of principles, it still embodies the main thrust of mainstream development approaches, yet something clearly has been lacking. Many countries that apparently have followed the key lines of the given script have not succeeded; this failure of practice is a key instigator of learning⁹.
- Actions cannot be divorced from process; economic development has to be driven and owned by countries and people in those countries. Change that appears to be driven by outsiders armed with imported solutions is often resented or, as often happened in countries with structural adjustment programmes when powerful groups saw their interests threatened, simply not implemented.
- Economic development has to take cognisance of and be grounded in local realities, knowledge of the *micro* and *meso* levels, not just the *macro*. These cannot be assumed away. There may be immutable truths in economic development, and a common set of principles embodying these, but there is no one-size-fits-all model that is right for every situation.

Second, concurrent with this experience has been a wider reassessment of the theoretical basis for economic development. This has been prompted by the above failures in development practice and resultant questioning of the neo-classical economic analysis on which it was based. More broadly, it represents a response to the failure of economics (as a discipline) to predict major shocks and trends in the world economy. Much of this new thinking is contained in the revival of interest in institutional and evolutionary economics (Annex 1).

The essence of this rethinking is that policy prescriptions have misunderstood the importance of local context. People's behaviour is driven not just by incentives shaped by prices – as conventional economics might suggest. This is a narrow and inaccurate view of what really counts – namely, the wider set of rules that impinge on people in their local situation. These can be formal rules set by organisations – such as laws or codes of practice – or informal norms and values that emerge from social structures and cultures. Approaches to development need to be informed and set within the context of these “rules” of the game; they need to work with this reality¹⁰. Two implications flow from this:

- a) there is no inevitable (Darwinian) evolution towards a positive system that encourages virtuous development. Countries can become stuck in paths of under-development and poverty.
- b) more positively, the rules of the game – the systems that shape behaviour - can be understood, can be influenced and can change through purposeful, focused action. It is this that offers opportunity for agencies and governments.

Of course, in putting poverty into the context of systems the development challenge is, in some ways, complicated! This may be regrettable but is inevitable. Having learned from the mistakes of over-simplistic *magic bullet* approaches of the past it would be ironic if what is proposed now is a new improved formula! However, while it is not possible to develop a tight definition, it is important to be rigorous in considering what is meant by “a system”. This is a subject that exercises economists at length. In particular, there is considerable debate (Annex 1) between those who see poverty's roots lying in “institutional” causes (formal and informal rules) and those who emphasise geographic causes (natural endowments, remoteness etc). From both, systems can be seen as having a number of inter-related elements:

- Rules: these can be both formal and informal. Formal rules include regulations, laws, policies, contracts, and rights and the means (mechanisms and organisations) through which these are implemented or enforced. Rules can be economic, social or political in nature. For example, in the *economic* realm, this can include business registration systems, commercial laws, arbitration procedures, codes of conduct, technical standards, consumer rights and taxation regimes. *Socially*, this can include membership organisation rules. *Politically*, this can include official procedures for consultation, performance assessment and accountability, decision-making processes and citizen's rights. Rules operate at local, national and international levels – including for example, trade rules.

Informal rules include norms, values, customs and practices that define right and wrong and the means through these are implemented – enforcement mechanisms used by cultures, social groups and organisations. For example, this might include norms associated with business exchange, gender roles, compliance with laws, trust, co-operation and attitude to work.

- Information: underpinning both formal and informal rules is information available to key players. For example, this might include knowledge on how to access finance and services, improve operations, and reduce costs; on who to go to in seeking assistance or advice and on price, technology and market trends, and how administrative and political processes operate.
- Physical realities: structural and geographic aspects of areas/regions provide a spatial and physical dimension to systems. For example, this might include: proximity to centres of population, services and markets; level of resource endowment and preponderance of disease.

The above categorisation is, of course, a simplification. It does not seek to list every “factor” that is important in an economy but rather highlights the underlying systemic

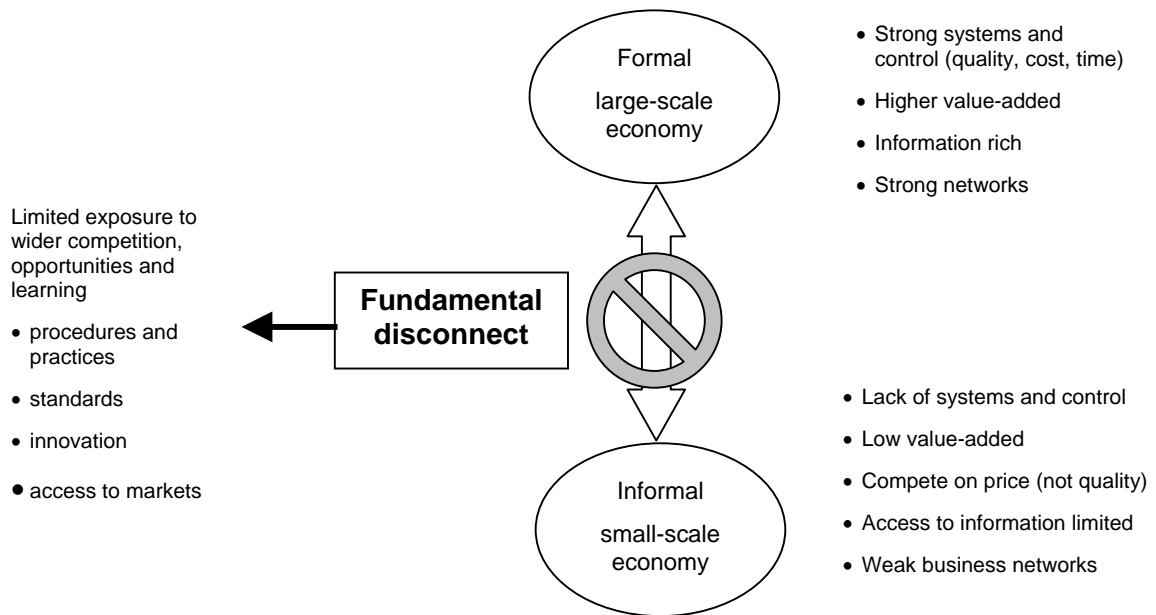
context. Technology and human capacity development, for example, are seen as a function of rules and information. Moreover, a bland grouping of factors in this way can under-represent the sometimes harsh (political) processes that have shaped and define systems.

The importance of understanding the systemic context of economies is especially apparent in Africa. Most African economies are characterised by *discontinuity*¹¹ (Figure 4). On the one hand are informal sector businesses employing vast numbers of people. Typically they offer low value-added products, compete on the basis of price for local customers, have loose procedures, limited networks and information access and are generally ill-served by formal organisations (such as banks). Unlike other countries (India, Italy), there is little meaningful collaboration between small firms to overcome disadvantages of scale, with no specialisation in manufacture and assembly and no business tradition of trust and exchange to foster this¹²¹³.

On the other are large formal businesses in information-rich environments, with formal procedures and disciplines, higher-value added products and linkages with a range of other formal organisations (such as banks). The rules (formal and informal) governing each of these worlds are very different and connections between them (for example in relation to outsourcing), often reinforced by ethnic differences, are minimal.

Effective development has to address this fundamental “disconnect”. Paradoxically, however, attempts at treating informal businesses separately or preferentially, divorced from the larger business system, can reinforce their difference and shield them further from the positive influence of the formal economy¹⁴.

Figure 4: Discontinuity in African economies



Given these different elements of systems, are there particular characteristics that tend to make systems more (or less) conducive to poverty reduction? Although, as always, local contextualisation is important, it is possible to indicate a number of typically positive, related features.

- Clear and transparent property rights: property rights are widely seen to be at the heart of market-based economic development providing the basis for commercial exchange and investment, leveraging additional resources and services. Financial services development in particular requires systems that recognise collateral pledged by individuals in return for a loan or other financial service. Yet, in many developing economies, even though individuals may feel they “own” property, this cannot be transacted because of inappropriate laws; it remains “dead capital” – property that cannot be used to bring life to economies¹⁵.
- Effective “voice” for the poor: mechanisms that allow the poor a voice (a channel through which decision-makers hear (and listen to) their views) generally help shape more equitable public policies and resource allocations. But how voice translates into action is not straightforward. Even in “functioning” democracies, it is common for the key beneficiaries of services deemed to be the responsibility of the state (notably health and education) to be the top fifth of the population, not those at the bottom
- Access to services: the poor require access to services and amenities that allow them to raise their capacity to engage in economic activity. Although sometimes equated with political voice, the mixed (but often poor) performance of state provision, has focused more attention on market-led approaches as a means of offering direct access and accountability that largely circumvents “complicating” political processes.
- Rule of law: with no private means for protecting their rights, the poor always benefit from effective law and order. Moreover, an appropriate legal and judicial system, by providing a secure and predictable environment and a credible threat of punishment for breaking contractual obligations, is associated with strong economic performance.

- Appropriate infrastructure: the spatial dimension to poverty – its greater preponderance in remote/peripheral regions and countries – makes adequate infrastructure an important condition in allowing access to markets and greater economic integration.

Box 1: Latin America “infrastructure” services: new relationships with the private sector to increase access¹⁶

After many years of public sector provision, the poor coverage, quality and efficiency of state-provided infrastructure-related services in a number of Latin American countries in the 1980s and '90s was considered to be so inadequate as to merit significant change.

Using different models, extensive “privatisations” of water, electricity and telecom infrastructure and services were implemented. These have caused a considerable controversy because of their alleged unfairness and anti-poor bias. However, beneath the froth of argument, objective analysis of impact in four of the main countries involved (Argentina, Mexico, Bolivia and Nicaragua) reveals a different picture:

- In all cases, access to services increased substantially. For example, water connections in Argentina rose by 30% between 1993 and 1999. Moreover, for water and electricity – where coverage among upper and middle income groups was already high – the poor benefited most.
- Prices rose in some cases and fell in others. Price increases tended to reflect one of two factors. First, reduction in previous (often large) consumer subsidies from the state, and second, inappropriate regulatory arrangements set by governments (for example, not setting appropriate incentives to expand and improve service quality and access). Overall, improved efficiency tended to force prices down.
- A strong welfare benefit for the poor. While the impact of any price increase was negative on existing consumers, the net overall welfare benefit from expanded access to more (often poor) people was strongly positive. In Bolivia, independent study showed that impact was positive for all but the top 10% of the population. In one case (in Argentina) a reduction in child mortality from a reduced incidence of parasitic and infectious diseases was attributed to improved water services.

More widely, involving the private sector brought noticeable fiscal benefits for governments from reduced transfers as well as initial sale revenues. In most cases direct employment did fall – and this fact may have been a reason for public objections. However, the wider benefits for consumers from improved access and quality – especially the poor – are beyond question

2.3 Markets within systems

Understanding the reasons for the varying performance of countries in addressing poverty requires probing beyond headline policy prescriptions to look at the broader systemic context. It is this wider system that determines how people behave and how development is pursued. Given this, why are some systems more effective than others? Why are some more *pro-poor* in their final outcomes?

Answers to these questions lie in markets. Markets contribute to and are shaped by the wider systems of which they are a part. More effective poverty-reducing countries have successfully recognised and utilised markets to help deliver the kind of positive features identified earlier – voice, access, rights etc. However, self-evidently, even frequently, this does not happen; and markets do not deliver for the poor. Fortunately, when this happens, it usually does so for discernible (and addressable) reasons (Table 2).

Table 2 illustrates very different situations. However, these are united, first, by a focus on identifying and addressing underlying systemic constraints and, second, by the potentially large scale of impact from such actions. This can be contrasted with the rather limited impacts typically achieved by development projects which usually concentrate on individual market players rather than the wider system. The still limited outreach in the microfinance industry – where donor support has been organisation rather than system-focused – is testament to the partial nature of the microfinance revolution.

Table 2: Common and market approaches to problems of the poor

Problem	Common approach and common results	Potential pro-poor approach utilising markets (addressing key constraints)
People want access to land!	Land allocation by administrative and political transfer. Commonly leads to capture and inefficiency	Develop independent land rental market or system of tradable land use certificates.
People want access to finance!	Protect the poor from usurious practices by imposing interest rate ceilings and/or support individual microfinance providers. Commonly leads to mainstream banks losing interest	Industry and government collaborate to agree on a future vision and plan to overcome fundamental market constraints related to for example, information, regulation, standards and product development
People want water!	As an “obvious” public good and a natural monopoly, this <i>must</i> be delivered by the state. Low coverage achieved at high cost.	Broad spectrum of regulatory frameworks possible, providing different arrangements for more efficient private sector providers.
People want good prices!	Provide poor producers services directly (from the state or development agencies) to improve their performance. Result – weak performance and increased dependency.	Identify and address critical systemic constraints in industry sub-sector preventing poor producers accessing appropriate services. Facilitate linkages between mainstream providers and “excluded” producers.
People want jobs!	Increase employees’ rights to enhance conditions and security. Result – limited labour turnover, weak job creation and high unemployment.	More balanced labour market regulation to reflect interests of excluded <i>outsiders</i> relative to <i>insiders</i> .
People want telephones!	State provision of this essential infrastructure service has usually achieved very limited coverage.	Provide appropriate licensing regime to attract private operators.

For many, the step to markets is not obvious. Or even welcome. The notion of markets can evoke suspicion and hostility. Commonly, they are regarded as instruments of oppression rather than providers of opportunity. And of course, there are examples of unmanaged market development impacting negatively on the poor. For example, unrestricted credit liberalisation has often been accompanied by damaging debt levels for ill-advised and ill-informed consumers. Poor choice and regulation of private water companies resulted in violent riots in Bolivia. More generally, markets are sometimes seen to be the domain of the rich, “theirs” and not the poor’s and therefore something from which the poor must be protected¹⁷¹⁸.

Such views are real. Less common is the recognition that it is often the distorted/weak operation of markets that disadvantage the poor (rather than markets *per se*) and that there are often very specific reasons for this situation. Or that tapping into markets effectively can bring vast benefits for the poor. Yet the evidence is clear (see Boxes 1-5); Table 3 is especially unambiguous.

Table 3: Access to infrastructure services in Latin America: before and after reform¹⁶

Country	Proportion of households (all)		Proportion of households (poorest decile)	
	Before	After	Before	After
Argentina (urban) – <i>telephone</i>	50.4	67.2	18.4	22.8
- <i>Water and electricity</i>	90.3	93.7	64.8	82.5
Bolivia (urban) - <i>electricity</i>	96.0	98.8	89.2	98.9
- <i>telephone</i>	25.5	31.0	2.9	7.9
- <i>water</i>	80.6	92.1	64.5	89.1
Mexico (all) - <i>water</i>	53.0	56.6	22.0	27.9
- <i>telephone</i>	18.6	26.3	2.0	3.9

Overall, the key reason for the relatively strong poverty impact of some countries lies in their recognition of the centrality of markets in poor people's lives and, second, in the relative success of their approaches to understanding and utilising markets to create a conducive environment to reduce poverty. This is easiest to understand with respect to a number of basic factors related to markets as they impact upon the poor.

1. The *pervasiveness* of markets: the poor always exist within markets and markets therefore always affect them. Just as the key actors in any market are buyers (demand-side) and sellers (supply-side) in contact to exchange goods and services so the poor participate in markets as:
 - Consumers – either in a domestic/household capacity or as small business owners (including farmers), as consumers of goods such as food, shelter and household items or financial, business services and health-related services.
 - Producers – usually the main “product” the poor have to offer in a market place is their labour but, as business people, also services and commodities.

Box 2: Trade liberalisation: substantial benefits for women employees¹⁹²⁰

Despite high levels of unemployment in Bangladesh, international trade restrictions historically prevented poor people from using their cost advantage in the labour intensive garment industry to gain employment. In 1990, this constraint eased with the introduction of the Multi-Fibre Agreement.

Since then, responding to the opportunities created by favoured access to foreign markets, Bangladesh's garment industry has grown five-fold. By 2002, export value was over \$4.5bn and more than 1.5 million people (two-thirds being women) were employed directly by the industry. Given the widespread debate over the impact of greater global trade on the poor the experience of Bangladesh is pertinent: has this substantially new industry benefited the poor in Bangladesh? Evidence from a variety of sources suggests that, with few caveats, the answer here is affirmative, especially for women.

- Those women leaving an earlier job for employment in the garment industry typically increase their wages 2-3 fold.
- Typically, these workers contribute 40-50% of household income. Without this income, in the absence of alternative employment, 80% of families would slide below the poverty line.
- There are reported negative impacts from employment: working hours are relatively long and there has been an increase in violence towards women. However, overwhelmingly, from the perspective of women, employment is associated with higher levels of self-esteem, improved networks and greater voice in household decision-making; it is “a valued route to greater personal autonomy”.

The experience of Bangladesh therefore indicates that benefits of trade liberalisation *can* filter through the labour market into wider poverty-reducing impacts, provided that labour market conditions permit firms to offer the poor employment opportunities. Moreover, these benefits manifest themselves not simply in terms of incomes but in relation to wider non-income dimensions of poverty.

For the poor there is no non-market option! Amidst the sometimes fevered discussions around globalisation, the more reasoned debate has been not about “markets: good or bad?” but rather about how the poor can engage in markets in a more beneficial manner.

2. The *direct and indirect* impact of markets: the poor are affected by market change directly or indirectly. As participants in the labour market, market changes impinging on the poor’s employers (actual or potential) also impact on them. International trade liberalisation, seemingly a long way from many poor people’s realities, can allow firms to export, in turn to employ more people (Box 2) and offer opportunities for poor farmers.
3. The *inter-related nature* of markets: although policy makers and businesses may isolate individual markets for their own purposes, in reality they are inherently linked in a range of ways. For good or ill, what happens in one part of an economy ripples into another. Positively, improved functioning of some markets therefore can lead to pro-poor benefits in another. Liberalised mass-media markets in many African countries has resulted in a growth in radio stations in particular and is facilitating improved information flow in markets relevant to small business as radio stations realise the importance of specific programming aimed at this audience²¹. Improved regulation around land and property markets can act as a stimulus for financial and business services markets. Telecom growth enhances information flow in many markets (see Box 3)

Box 3: Telecom market development in Africa: a changed role to increase access^{22 23}

Telephones in Africa have historically been regarded as service offered and controlled by government. After years of state provision, coverage in total was around 2% of the population, and much less than this among the poor, for whom it was generally a distant, luxury item for the wealthy.

The arrival of new mobile phone technology in the 1990s offered a convenient opportunity for African governments to play a different role. Rather than provision, governments role has shifted to licensing and regulation of private sector players; what was previously seen to be a “public” service provided by the state has been opened out and is now regarded as a private service regulated by government

The resulting impact has been dramatic. The growth of mobile telephony (78% per annum) has been faster than in Africa than in any other continent. By early 2004 25 million Africans were mobile phone users – 4.5% of the population – and growing by approximately 11 million every year. Two characteristics of this growth stand out. As a provider, African governments have managed to provide 10 million fixed line subscribers in total; as a regulator of the private sector, the number of new customers annually is exceeding this figure. In two years in Nigeria, mobile phones have grown to four times the total number of land lines.

Enhanced access has brought considerable benefits for the poor as consumers. When given the choice, the rural poor spend as much on telecommunications (as a percentage of income) as urban consumers. Moreover, the emerging market has spawned a variety of innovative new services – a mini telecomm economy - that reduce costs further for poor consumers. In Senegal for example, 6,000 privately operated and profitable telecentres have come into existence. Poor people, like telecom consumers generally, use this new access for a variety of purposes but it is clear that some uses – especially information on market trends for farmers – are improving their competitive position in other markets. Benefits for the poor have emerged not through any preferential targeting of under-privileged groups by operators but by recognising them as valid consumers, just like any other.

Early evidence from Africa supports general findings from research indicating that the incomes of the poor grow faster in telecom intensive economies.

4. The *malleability* of markets: critics of markets are wont to emphasise market forces as a blind and uncaring beast which, once unleashed, charges into whatever lies in its path. And, to some extent, these fears are understandable: the whole purpose in working with markets is to tap into energy and innovation that otherwise would be dormant or redirected. However, it is clear that the development of markets can be influenced significantly by conscious decisions and actions such as changes in the role of government, new regulatory rules, changed attitudes,

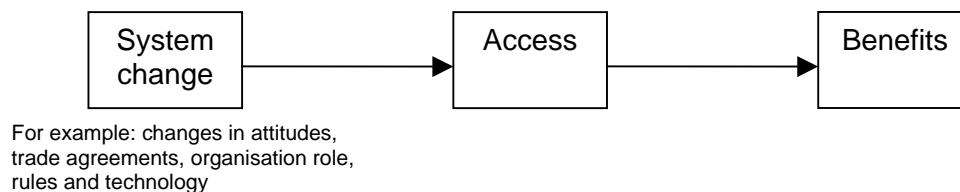
new infrastructure or technology. For example, the trigger for China's period of rapid growth and poverty reduction began in 1979 with the introduction of the "household responsibility system" under which peasant farmers, for the first time, were able to keep surplus production; in a five year period net agricultural output increased by 45%.

2.4 From market development to poverty reduction

Markets therefore are an inherent part of the system around the poor and currently (frequently) act in a way that disadvantages the poor. "Pro-poor" market development takes place when fundamental changes result in considerable gains for the poor.

In the context of the above, recent years have thrown up considerable evidence of the power of market change to influence the lives of the poor. The precise route through which the poor may benefit varies but essentially is one where change is initiated, leading to enhanced access and to poverty-reducing impacts (Figure 5).

Figure 5: The path from system change to poverty-reducing benefits



Improved access for the poor

As consumers of goods/services in markets as diverse as water, electricity, telecom services, land, and finance, there are many examples of substantially enhanced access to the poor. As workers (producers) in the labour market, the poor have also benefited considerably from additional employment derived from trade liberalisation.

results in

Improved benefits for the poor

Clear evidence exists that better access translates into a range of benefits. Welfare gains from increased access to water and electricity, higher outputs, investment and productivity from improved access to land, a spectrum of information and other benefits from improved telecom coverage and significantly higher income and wider social gains from extra employment provide hard examples of pro-poor benefit.

and stems from

A range of change triggers

Making markets work more effectively can be instigated by a variety of factors. For example, by changed attitudes, new technology and new trade agreements. Most important, the rules shaping market behaviour can be transformed by a willingness from the state to play a different role and to develop a new partnership with the private sector in doing so. Conversely, positive change can also be inhibited if the

wrong rules are created (for example in relation to supervision) or players do not have the capacity to play new roles in an appropriate manner.

How to identify and initiate key opportunities for change (triggers) is the challenge to which the rest of the paper now turns.

Box 4: Overly-strict employment protection legislation (EPL) inhibits inclusive labour market development²⁴

Unemployment in Croatia is high and rising, particularly among the young; in the 15-24 age-group, the unemployment rate is over 40%. This growing labour market problem is symptomatic of slow job creation, which in turn is a manifestation of barriers to entry to new firms, and, more important, to expansion of existing firms.

Analysis shows two related structural impediments to employment-creating business growth. First, strict EPL raises the costs of hiring and firing employees. EPL in Croatia is much more severe than in countries with flexible labour markets (and low unemployment), such as Hungary and the U.K. Self-evidently, strict EPL, while “protecting” existing employees, does not prevent high unemployment arising from the continual stream of new entrants into the labour market.

Implicitly related to strict EPL, job creation is slowed down by high unit labour costs. Relatively high wages in Croatia are not based on proportionately higher productivity, nor are they explained by payroll taxes, which are relatively low. Rather, they are shown clearly to result from the wage pressure exerted by *insiders* - workers with protected, secure jobs and thus a strong bargaining position - employed in large state owned or privatised enterprises. By inhibiting job turnover, strict EPL in Croatia hinders productivity improvements and thereby lowers the rate of economic growth. It also provides a strong incentive to firms to move to or remain in the informal sector.

Clearly, reforms of EPL and the wage bargaining system are key to improving labour market (and wider economic) performance in Croatia.

3. Markets are complex: understanding key debates and characteristics of markets and the poor

Markets are important yet currently – frequently – markets operate in a manner that disadvantages the poor. How markets develop and interact with the poor is influenced by a number of factors, some of which are within the purview of governments and development agencies. Turning the apparent potential of markets to reduce poverty into practical actions is the next challenge to be faced. What are the implications of MMW4P as a critical objective for governments and agencies? What should be done to “get the best” from markets?

While detailed answers to these questions are beyond the remit of this paper, Section 4 introduces some important basic steps. Before then, however, in order to focus on implications meaningfully, some of the complexity of markets – debates and characteristics - as they impinge upon the poor needs to be highlighted.

3.1 Markets and morality

Poverty reduction is a moral purpose. But markets are not moral. Arrangements of buyers and sellers, they are driven by the private self-interest of key players rather than, for example, a wider notion of the greater good. Individuals within markets of course do have their own sense of right and wrong but, as entities, markets are amoral.

How therefore can making markets work for the poor be a coherent concept and goal? Is there not – critics ask – an inherent contradiction between the moral objective of reducing poverty and the amoral means through which it is pursued?

There are several responses to these concerns:

1. Private and public gain: the essence of market economies is that – in market players’ pursuit of their own interests – wider benefits accrue to societies as a whole. The competition and choice offered in markets means that businesses are continually pressured to improve their efficiency and products and, in doing so, offer better value to discerning consumers who have can take their custom elsewhere if unsatisfied, a choice denied them otherwise. Both consumers and producers benefit through the market transaction and, more broadly, greater wealth is generated through improved aggregate efficiency and output. In recent years more attention has been paid to firms’ corporate social responsibility (CSR). For large corporations, CSR has formalised a wider stakeholder environment – financial markets, consumers, existing and potential employees and governments – that they need to take cognisance of. However, while CSR is an important issue, it is not a substitute for firms’ primary impact generated through market transactions.
2. Moral outcomes but practical means: the lack of moral purpose in markets is a particular concern when looking at potential private sector involvement in “public” services that have previously been seen to be the domain of the state. However, this may misunderstand the essentially practical nature of many “supply” tasks. These can be broken down into tangible deliverables – connection rates, maintenance schedules, system losses etc. – and success in achieving these is a function of efficiency and competence rather than motivations. Moreover, by reshaping the rules governing markets, commercial incentives can be set to achieve “moral” outcomes, for example, in water provision licensing agreements. In this sense, where utilising markets has allowed enhanced service and coverage (and there is evidence that it has) it has done so by tapping into greater managerial efficiency in the private sector (relative to the public sector).

3. Markets and rights are not mutually exclusive: another objection to markets is that they do not respect people's rights; i.e. citizens entitlements to specific rights related to education, water, security etc. Rights proclamations have abounded in recent years but do not deal with *how* obligations can be met. Aimed at creating a moral and legal climate that will force action, their value is, in some ways, symbolic but if not acted upon effectively they fall quickly into disrepute. Many developing countries are signatories to agreements and replete with ambitiously progressive laws that they have no capability to implement. One key problem here has been that the pursuit of rights obligations has been interpreted as a responsibility that government has to deliver directly – something that cannot be “risky” with the private sector. Yet, as is clear from many examples, engaging with the private sector - without abandoning objectives but by assuming a different role - can help governments meet their obligations more effectively.
4. The empowering nature of market-based relationships: markets are based around transactional relationships. Services and goods are offered in return for some kind of payment. The relationship is based on exchange and on mutual-benefit when both parties have legitimate and, to some extent, equal roles. Market-based relationships can be contrasted with those prevalent in a welfare or charity situation, where the two parties are a patron/benefactor and a recipient/beneficiary, and the relationship is essentially one-way: welfare offered but with no requirement of any quid pro quo response. Notwithstanding the need for welfare systems, these are inherently unequal relationships and, inevitably, it is more difficult for people to develop self-respect and responsibility – and the genuine empowerment to allow them to climb from poverty - on this basis alone. Players in markets, on the other hand, are conscious that they are in an exchange relationship: as consumers or producers they have power and the other party confers on them the respect associated with this. Efforts to promote the empowerment of disadvantaged people – such as Black Economic Empowerment in South Africa²⁵ – that focus on final outcomes and attempt to short-cut markets run the risk of:
 - denying people the opportunity to learn and develop from market participation and
 - nurturing, not empowerment, but a more privileged version of the “project culture” that so characterises income generation schemes. People become empowered only through empowering processes.

3.2 Winners and losers

The fact that markets are not institutions of right and wrong and that they are competitive, with firms and individuals juxtaposed *against* each other, often means that there are apparent winners and losers in situations of market change. A number of points can be made here:

1. More transparent and equal benefits from the market allocative process: introducing market disciplines into sectors that were previously controlled by the state usually meets with objections. Some of these are from existing employees, who fear change to previous practices. Usually also, change is opposed on the basis of its alleged anti-poor impact. However, as seen in numerous examples, introducing the private sector usually increases access for the poor. “Losers” in these situations are those who have benefited most from previous decisions – the winners of previous political and social battles - and now find themselves a consumer, like any other. In this sense, private sector involvement helps to redress imbalances of the past and can be a practical means to correct endemic failings in political processes. And, for the poor, the status of consumer frequently has more tangible meaning than that of citizen. Certainly, it is important in

assessing privatised services to compare their performance with the actual record of previous, usually state provided services – not with a utopian ideal bearing little relation to mediocre practice.

The capture of benefits of supposedly public services by non-poor groups is a familiar pattern found in many countries in markets as diverse as water, land, telecom and health (Box 5). And in labour markets. Clearly, labour is not simply another commodity – and rights and obligations are more important here. However, regulation and practices are often clearly for the benefit of existing job holders, at the expense of those without access (i.e. the unemployed).

Box 5: Land markets: changing the system to increase access^{26 27 28}

For poor people in rural areas, land is usually seen to be a critical asset. Increasing their access to land is often a priority for governments and, commonly, this objective has been pursued by imposing various restrictions to protect the poor but with limited success.

In recent years, however, a series of innovative reforms have demonstrated that making markets more effectively improves the poor's access.

- In Mexico, the abandonment of restrictions on land rentals in 1992, far from resulting in concentration of land ownership and destitution for the poor, brought about positive impacts on productivity and equity – and a general stimulation of the land market.
- In Ethiopia, in those areas where land markets have been permitted to operate, there has been a clear transfer of land use from those with land (but low ability) to those with ability (but no land) generating greater equity and more output.
- In China, the emergence of rental markets over the last few years has allowed more opportunity to gain access to the land by poor (but efficient) producers who otherwise would be denied this resource.
- In Vietnam, a system of land use certificates has been introduced that confers on households the right to exchange, rent, mortgage and inherit – changing individual's sense of ownership and incentives and leading to growth in longer-term investments.

In all three cases, reforms to stimulate the market for rented land, has proved a more effective means of enhancing access for the poor and promoting equity than administrative allocation which is both inefficient and, seemingly inevitably, captured by the well-off and/or well-connected.

2. Potential distortion from ill-considered interventions: again in the name of the poor, development agencies and governments frequently intervene in markets to change prices in favour of poor consumers. However, interventions can generate wider distortions that harm rather than help poor people:

- Low prices for agriculture outputs fixed by state marketing boards for many years represented a direct cross-subsidy from rural areas – where many poor people are agriculture producers - to urban areas – where many of the beneficiaries were middle-income consumers. Moreover this suppression of prices lowered producer incentives: when reforms took place output increased typically by 30-50%²⁹.
- Direct provision of often free or massively subsidised business services: (such as training and advice) for disadvantaged group can easily displace actual or potential private providers. Even if these services are of limited quality – and general experience indicates that these are not suitable roles for public bodies – their existence and their artificial price may undermine the development of markets to serve disadvantaged business. State supported business services are generally characterised by weak outreach, sustainability and impact³⁰.

These examples show not that subsidy is not bad per se but that introducing subsidies into market situations without due care can easily have wider and unintended impacts that distort and undermine any benefits (see section 4)

3. Markets are not inimical to welfare: markets respond to consumer demands and therefore, logically, will not serve those who have no demand – who have no

ability or willingness to pay. This stark reality again provokes questions: “what’s in it for the poor when markets are only after their money?” There are four immediate responses to this charge

- a) historically, organisations have often underestimated poor people’s willingness to pay for services and quick to categorise them as candidates for welfare rather than seekers of value. Many examples testify to the flimsiness of this view; globally the microfinance experience and that of other services (such as health care³¹) shows that people choose to pay for appropriate services.
- b) markets are neither a panacea nor platform for cosy harmony. Producers’ and consumers’ interests in particular, often diverge. Small-scale grocery retailers (a common business choice of the poor) may suffer when faced with corporate retail competition - but only if consumers vote for this with their custom. Provided competition is maintained^c consumer benefits are likely to outweigh producers’ costs.
- c) markets are not a panacea for society’s ills and do not provide a substitute for welfare. However, in generating wealth they may provide more resources that can be used for redistributive purposes.
- d) one consequence of more global trade is more exposure of greater numbers of people to global competition. While this may bring substantial benefits (Box 5) it also bring risks and emphasises the importance of welfare safety nets to shield people from the worst effects of competitive strife.

3.3 Market imperfections

Economics texts highlight a number of different market imperfections or failures to which markets are subject that may mean they do not allocate resources efficiently.

- *Externalities* exist when the production or consumption of a good or service has spill-over effects that are not reflected in the market price. Negative externalities include pollution; positive externalities include the benefits of a literate population.
- *Public goods* are nonrival (consumption by one does not reduce the supply to others) and non-excludable (users cannot be prevented from consuming the good). Private firms will not therefore supply public goods because they cannot appropriate the benefits.
- *Asymmetric information* occurs when suppliers know more than consumers or vice versa leading to under or over supply of particular goods and services. Credit and insurance markets are especially prone to information failures.
- *Market power* will impact negatively on a market when producers can restrict competition and exact monopoly profits

These definitions of market imperfections are useful in defining the limitations of markets and are commonly cited as a justification for public intervention of various kinds. However, the common usage of these terms is less useful in two senses. First, it does little to illuminate the complexity and nuance of *real life* market situations. In particular, services may be designated public goods with little scrutiny of their real nature. In fact, by the standard definition, there are very few public goods; there *are* many goods and services that, it could be argued, have a public goods aspect but these levels of nuance can become lost when services are labelled – as though written in stone – “public good”. Second, they do not provide a prescription for a specific course of action for governments from among the range of options open to

^c The regulators’ role is particularly important in this kind of situation

them - such as direct provision, regulation, licensing, information provision and research. Yet, commonly the pretext of market failure is used as a sprawling, carte blanche justification for direct state provision with little consideration of other options.

In reality, therefore, although useful in highlighting market characteristics, standard economic terms can be interpreted in a simplistic and clumsy manner to rationalise similarly ill-considered state intervention. They are often unhelpful in thinking through *how* a market can work effectively for the poor. Market systems can evolve (and be encouraged to develop) to address some apparent market failures. For example:

- Shifting public and private definitions – there are a range of examples of key services that were once seen as the domain of the public sector and are no more. Telecoms, financial services and technical training are now primarily a private sector provided service – yet all have been seen as public services.
- Externalities – such as environmental pollution – can become the basis for a new market (in pollution control hardware and services) if appropriate rules are set.
- Market-based solutions to information problems: the growing complexity of economies has made information and knowledge a critical resource. The growth in business services (the fastest growing sector in many economies) is a response to this trend.

3.4 The dynamic nature of markets

Markets are not static. Part of the energy that is released by market development is continual innovation and change. Markets' character is fluid and dynamic. One implication of this is that, in considering the poor's direct participation, more important than labelling markets as pro- or anti-poor, is to assess the degree to which market *development* processes - processes of change - are to the benefit of the poor.

This is more than semantics. A widespread problem in development interventions is their focus on immediate manifestations of problems rather than underlying causes. Yet, the essence of development (and what differentiates it from welfare) is its focus on causes (not symptoms) so that positive impacts can be achieved now and into the future. Making a lasting, sustainable difference requires that core systemic reasons for underdevelopment are recognised and addressed: rather than ask "what problems do the poor have and how can we help solve them?", the question should be "what problems do the poor have and why isn't the market environment providing solutions to these?"

Answering this question requires that the assessment of market development processes moves beyond a standard view of markets. Traditionally, markets are seen as having one core function – delivery and consumption. However, this view says little about processes of change, about what needs to happen for markets to innovate and to grow. Just as previous policy prescriptions have sometimes failed because of their inability to understand process, so, in engaging with market development, it is important to recognise how markets change and the different functions required for change.

Figure 6 provides an overview of the range of different functions that may be required in a dynamic market.

Product development: just as consumer needs are not static so producers need to predict, react to and instigate product change. Product development might take the form of technical redesign, new service features or image and branding change.

Basic research: more fundamental research may also be necessary to promote change. Not related to one specific product, this might include, for example, research

on consumer attitudes to credit, new seed varieties, methods of social organisation among farming communities or business' experience of accounting services.

Information: for both supply and demand sides information on trends and opportunities related to, for example, prices, technology and laws, is essential to guide current and future actions.

Regulation: formal rules are required to shape incentives, define limits and set standards. As economies become more sophisticated formal rules are likely to substitute for informal rules as seen, for example, in the growing importance of certification as a passport to participation in many markets and of governance and regulation of markets by the state.

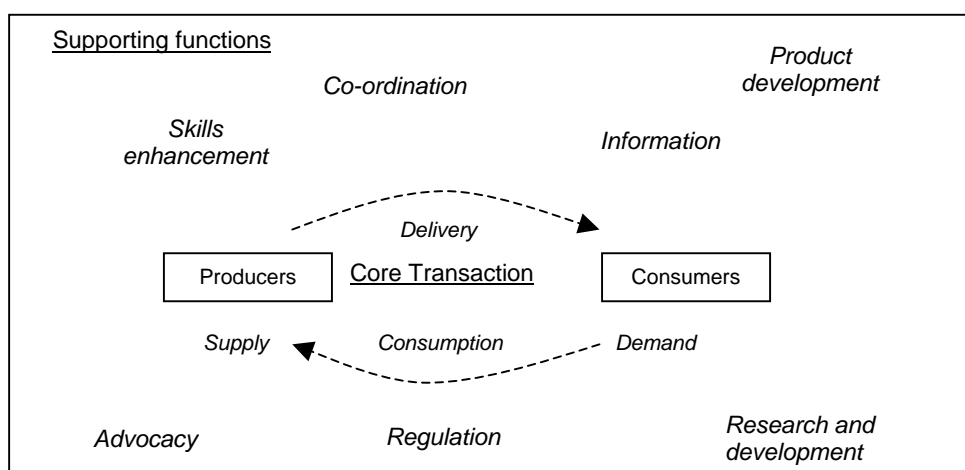
Skills development: underpinning business change of any substantial kind, new skills and knowledge on the part of producers is required.

Advocacy: the multi-stakeholder environment of markets may also require a formal voice to ensure that the collective perspective of producers or consumers is heard.

Co-ordination: in some markets, addressing collective strategic issues that are over and beyond individual players may require formal coordination.

Functions' relative importance vary from one situation to another, as does the degree to which they are formal, separate tasks rather than subsumed within other functions. But, however undertaken, these functions do underpin processes of market change.

Figure 6: Functions in a market³²



3.5 Roles of key players

Recognising different market functions takes market analysis into the real world. In doing so, it addresses the complexity sometimes assumed away in standard economic analysis but it shows in a more pragmatic sense what happens in dynamic markets. Acceptance of the *multi-function nature* of markets also raises a new question: who should undertake (and pay for) these functions? In addition to the core players of providers and consumers, there are clearly many other players involved in markets – who can and do undertake key functions. In trying to assess what should be done to promote more inclusive markets, the roles key players are playing currently – and the role they should play in the future – needs to be understood.

In general, there are four categories of players in most markets^d:

- *Private sector*: the key supply-side players in most markets engaged in the core market function of product delivery and usually the related tasks of product development and skills enhancement. The private sector can include businesses of any size, ranging from large-scale to microenterprises.
- *Government (and government agencies)*: this category can be broken down further depending on the context but can include national government departments, regional and local government and state agencies. Government's existing role can drift across the spectrum of functions. Commonly, in services which are deemed to be public, it plays a direct provision role (such as agriculture extension); often it seeks to be a source of R & D; and frequently it is involved in skills development. In general, as developing more productive relationships with the private sector assumes more significance, government's role as a regulator is becoming more important. It is less usual for a clear view of government's role to be forthcoming.
- *Representative organisations (business, consumers etc)*: business membership organisations' core role is usually advocacy but can also be involved in industry self-regulation, information provision, co-ordination and skills development. Consumer representative organisations are not as common as their supply-side counterparts but can be important in advocacy and improving information.
- *Not-for-profit organisations*: this can include relevant NGOs, research foundations and higher educational institutions. Their current roles include, typically, R & D, skills development and information.

A fifth category of player in market situations might be included. *Business networks* are not always manifested in a formal organisation (and so sometimes can be seen as a slightly amorphous notion) but their influence can be significant – especially as providers of information and in self-regulation. Although they are frequently involved in markets, including international development agencies in an analysis as simply “another” player runs the risk of building dependency on them and of confusing their real developmental role; to facilitate others rather than be a market actor *per se*.

There are typically, therefore, a variety of different players in a market context. There are also a number of different functions that need to be undertaken to allow markets to develop. In examining what governments and development agencies can do to support MMW4P, assessment of functions and the roles of key players is a critical task. This is considered more in the following section.

^d The consumption of goods and services – the demand-side – is by consumers of various kinds; the focus here is on the supply-side.

4. MMW4P analysis and actions

Given this importance and this complexity, how then should organisations make sense of MMW4P? What does it mean for them in terms of what they do and how they should do it? How should they take a commitment to MMW4P into their working context?

While a key message of this paper has been to warn of the problems of overly-simplistic approaches, there is an equal danger that, in recognising the importance of grounding actions in the local context, the impression is given that there is little cross-learning possible, that ultimately “it all depends”. This would be a denial of experience; there are real “generalisable” lessons to be learned.

This section outlines four overarching considerations that organisations should take account of in developing their approach to MMW4P. This is not an alternative to methodologies/tools such as sub-sector analysis, market research techniques and competitiveness analysis. Rather it is a brief outline of major issues that should be addressed - no matter the methodology. It is an invitation to think rigorously about MMW4P and a contribution to how it may be operationalised within organisations. The section includes with two narrative mini-examples demonstrating these steps in two very different market situations.

4.1 Delineating the market

A starting point for any organisation is to delineate “the market” in which it is interested. This is important because of the need for organisations, on a practical basis, to maintain a focus. Markets can be delineated with respect to several criteria:

1. Factors of production: land, labour and financial services^e - associated with core factors of production – are sufficiently important within economies to be considered as a separate criterion. Factor markets influence all parts of an economy – and arguably – focusing on their functioning has more influence than any other market. In this sense, they should always be a priority for action.
2. Commodity, product or industry: for example, this might include agricultural commodities (cotton, wool, citrus fruits etc.) or manufacturing industries (garments, plastics, automobiles, etc.). Where particular industries have actual or potential importance in an economy, focusing on them may be an obvious choice. However, this inevitably becomes a complex task. “Vertical” sub-sectors always include a number of service markets within them. In manufacturing industries, sector maps and relationships are even more complicated; there are markets within markets. Two examples make the point:
 - In any agriculture sector, MMW4P for the poor (as producers primarily) has to address markets for hard inputs (seed, fertiliser), soft inputs (advice, information knowledge), downstream market services (auctioning, transport) and the contractual and financial services underpinning these services.
 - Having grown from \$2.6m to \$11.3m in 9 years through active export marketing, the basket handicraft industry in Ghana faces new competition from Asian producers. To regain their competitive advantage, Ghana’s producers need to address problems related to quality, production, design and service. Many traditional producers in rural areas are poor; for the basket market to work for them, specialist services markets related to quality, design and marketing etc. must develop and companies must invest in these services³³.

^e Finance is capital in monetary form – so related to but not the same as capital

3. Business services: for example, accounting, transport, design, marketing, logistics, communication and media. These “horizontal” services are inherently more cross-cutting in nature and feed into many industries and sectors. While business services sometimes suffer from being seen as intangible – and a lower priority than tangible and wholesome production – for most economies they are the fastest growing sector reflecting the growing importance of knowledge, information and the service dimension in business.
4. Geographical area: markets within one city or region or country. While this might be a logical focus from an organisation perspective, they are artificial and arbitrary from a market point of view. A concern for rural areas, for example, may be easiest to interpret by focusing on particular markets within them.

Markets can therefore be delineated in a number of ways. Impinging on all of these choices is the remit of organisations and their ability to impact meaningfully on particular markets. From a practical perspective, there is no point in identifying markets that cannot be influenced. Factor markets, for example, where many of the important rules are set on a national basis, require a national remit.

4.2 Understanding markets currently

Any action by government or development agencies aimed at MMW4P has to be done on the basis of a detailed understanding of a market’s current situation. Actions therefore are thus shaped by analysis. There are several aspects to a market analysis.

1. What are the wider influences on and prospects for the market?

For commodity and service markets in particular, the wider set of influences on their prospects needs to be understood – even if they may seem rather distant from the poor. For major industries, this will include trade, technology and consumer trends as well as the actions of competitors. For example, for commodities, the wider issue of industrialised nation import barriers and agriculture subsidies affects farmers as a whole; the poor cannot be isolated from the bigger picture.

2. Where the poor are in markets: what is the current level of market participation?

The poor participate in a market as consumers or producers either directly or indirectly.

- As consumers, services such as finance, water, electricity and food are important and, in rural areas, agricultural inputs. For these, the key indications of market engagement are use/consumption (are they consuming and, if so, how much?) and their perception of these (satisfaction and image).
- As producers, for example as small-scale farmers, participation is shown in their number and in the prices or margins they achieve. As employees, numbers and wages are key indicators. For general labour market analysis, of course, a key indicator of market development is non-participation (i.e. unemployment).

Either as producers or consumers, the poor’s position must be put in the context of the overall market. For example, the fact that the margins for emergent black wool farmers in South Africa is typically 22 rand per animal is relatively meaningless unless put in the context of commercial farmers (89) and traditional farmers (4)³⁴.

If the poor’s participation in markets is not direct, the route through which markets can impinge upon them needs to be identified. This might be solely on the basis of growth benefits – increased spending and transfers to government. Or, it may be on the basis of more direct linkages – for example, extra employment from improved business competitiveness. For the poor, indirect benefits of market development can often be as significant as those impacting on them directly.

3. What is the existing structure in terms of key functions and players?

As discussed in section 3, markets are more than a simple exchange function undertaken by buyer and seller. There are other functions that are critical for market development and a range of other players. In order to gain an understanding of the market structure and processes, it is important to know who is doing what and who is paying for what.

One way of achieving a transparent picture is by use of a framework (Figure 7) linking players with functions and linked by two key questions: who does? and who pays? Typically, although generalisation are fraught with peril, this kind of analysis reveals overlap and blurring in roles, especially with respect to government, confusion of roles frequently exacerbated by donor support and clear contrasts between different groups within markets.

Figure 7: Market functions and players framework³²

Functions	Players	
	Who does?	Who pays?
Delivery		
Product development		
Skills enhancement		
R & D		
Information		
Advocacy		
Regulation		
Co-ordination		

Key players
 Private sector
 Government
 Not-for-profit organisations
 Representative organisations
 Business networks

The key benefit of a framework such as that in Figure 7 is that it provides a basis for transparency – and therefore a mechanism through which key players can discuss the role they play now and should play in the future.

4. What are the current (systemic) factors impinging on the market?

Having gained a picture of a market in terms of the poor, its prospects, and structure (in terms of who does what), the underlying reasons for this situation need to be identified and explored. In doing so, the systemic constraints impinging on the market should emerge. Under the broad headings identified earlier (formal rules, informal rules, information and physical constraints), these might be, for example:

- Poor information about how to reach and serve previously underserved groups well beyond traditional, historic private sector focus
- Government mandates or general expectations to deliver directly rather than facilitate others to do so
- Lack of clarity over government's, BMOs' and NFPs' roles sending mixed signals to the private sector
- Consumer ignorance over the behavioural norms and value in particular markets
- Specific regulations governing the relationship between the private sector and government
- Lack of standards to guide both providers and consumers
- Infrastructural weaknesses undermining access in peripheral areas

- Disconnected business networks resulting in weak information flow and collaboration
- Poor levels of information on current performance
- Technical and organisational capacity limitations in relation to key players

Emerging from all this should be an analysis of: the market and the poor within it, its prospects and wider influences, its structure in relation to key players and functions and the underlying systemic constraints that prevent it from functioning more effectively. In short, what should emerge, is an answer to the central question: why isn't the market working?

4.3 How is it envisaged that markets will work more effectively in the future?

A detailed analysis of a market's current situation provides the basis for developing a picture of how a market can work in the future. There are two aspects to this: strategic and operational.

From a strategic perspective, the key question is what should be the role of different players in relation to key market functions and why should they play these roles? Strategic neglect has been a characteristic failure of much development endeavour supported by donor agencies. This has taken two forms. First, commonly, organisations have been supported to play roles without considering whether there was any valid *rationale* for them doing so. Second, they have been supported to play particular roles with no clear vision of how these would be delivered (who does?) and financed (who pays?) in the future – i.e. with no clear picture of *sustainability*.

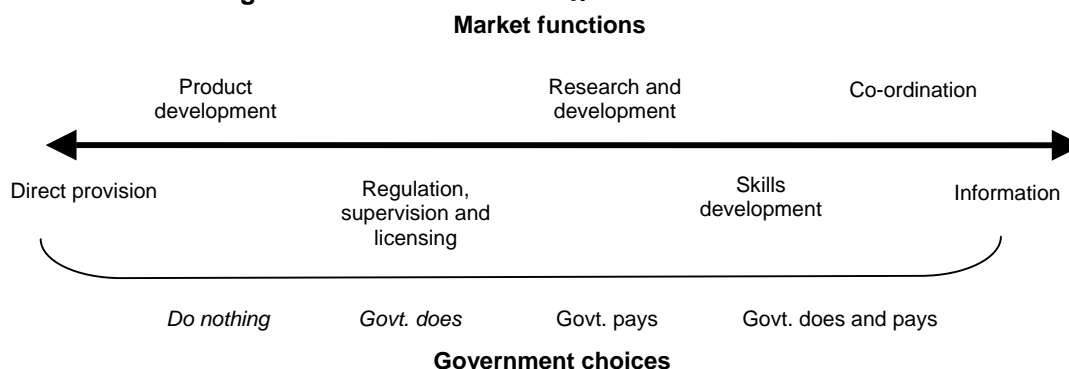
As a consequence of these strategic failings, organisations have been introduced to and continued in roles for which they are not suited and where their performance has been poor. Moreover, there are many examples of relatively intensive project inputs fostering organisations with practices, cost bases, and models of service that cannot be sustainable without further, substantial external support. For example, BMOs have been supported to play delivery roles well beyond what they know and own or are expected by members – becoming deliverers of training and credit. Governments have been supported to deliver services directly even when their performance has been poor and capacity weak such as agriculture extension systems that are often moribund and failing.

The framework summarised in Figure 7 provides a simple matrix to outline functions and roles transparently. But it is not a prescriptive tool. For it to be of value, governments and development agencies need to wrestle with the critical strategic question: in the context of any market, what should organisations do and why? Two key issues need to be considered here:

1. Core competence: what is the distinctive advantage of particular players? What is it they can do better than others or that only they can do? For example, BMOs may be uniquely positioned to play an advocacy role because of their collective, representative nature. Not-for-profit organisations, including universities, may be best placed to undertake independent research or provide particular types of information.
2. Capacity: organisations' view of the role they play has to be informed by a realistic assessment of their capacity. Indeed, a common problem for many developing countries has been "models" of government action from well-resourced high-income economies imported into their low capacity contexts. One implication of the capacity question is that strategic decisions must also take cognisance of operational realities.

The role of the state is of central importance in determining how markets should function in the future. Government is unique both in the power and importance it has and in the range of roles it can assign to itself. In considering the strategic role it should play there are a spectrum of possibilities (Figure 8). Choice of role can be influenced by a number of factors but there is a growing body of practice globally on different government roles. While precise formulae do not emerge from this practical experience, there are clearly several points of learning that *should* be key influences.

Figure 8: Potential different government roles in markets^f



- For some types of service, direct provision by government, usually on the basis that the service in question is a deemed a public good, has often been outperformed by a change to a supervising, regulatory role and involvement of the private sector. The rationale for water, electricity and telecom – which consumers pay for directly like other goods – being offered by government is often weak. Even for other services that have a stronger public goods dimension – public health, primary education, security – the same general reasons that often lie behind poor government delivery elsewhere (the efficiency of public sector organisation) are relevant. The potential of private sector delivery paid for and monitored by government has not been explored extensively.
- Basic R & D – the generation of public knowledge – is often regarded as a core role for government. Defraying risk for the private sector, it should encourage innovation and investment. Certainly, there is clear evidence that agriculture research contributes to productivity growth and this, in turn, reduces poverty. Moreover, it could be argued that a wider research role assessing impact and benefits is appropriate in markets where there is a redefined public: private interface and innovative approaches to delivery are being pursued. However, a responsibility for R & D does not require that government undertakes this directly itself. Drawing in (paying for and contracting) appropriate specialists to undertake research may offer government the opportunity to play this role more effectively.
- In an era of liberalising mass media markets and new communications technology, the position of information in markets is changing. Information related to market and technology trends should usually be generated from within markets. Government's focus should be on information that is unlikely to emerge from elsewhere - related to, for example, standards, regulations and laws, and to consumer rights and responsibilities, especially in situations of reform and change, where markets are reaching out to include new people.
- Skills development is an area where public and private interests often overlap. Developing educated and knowledgeable people through children's education is

^f This excludes government's role as a consumer – which can be important.

Mini-case 1: Making markets work for small-scale wool farmers in South Africa³⁴

1. Delineating the market

This market is defined with respect to the key players in the vertical chain of value-added linking wool farmers to final wool consumers. This includes players such as breeders, input providers, brokers, spinners and exporters. As well as buying and selling of wool at various stages of processing, therefore, a range of other formal and informal services– and the flow of information associated with these - need to be considered.

2. Understanding the market

(a) *Trends*: globally, after a decline in world prices and a more recent reduction in output, price stabilisation at relatively high levels is anticipated. In South Africa, wool production has declined by more than 50% in 10 years, reflecting a number of factors such as better returns in other activities. However, global trends offer opportunities for SA production. Moreover, the recent fall in output has left over-capacity in processing; processors need more wool.

(b) *The poor and the market*: wool production is dominated by around 9,000 commercial farmers who produce 97% of output by volume (and more than this by value). The remaining 3% is generated by an estimated 200,000 other small-scale producers, many of them poor. This is not an homogenous group – with a smaller grouping of emerging farmers (of up to 20,000) beginning to use more organised herd and health management practices. The divergence in performance between different growers is reflected in returns per animal. For commercial farmers these are R89; for emerging farmers R22 and for the rest less than R4.

(c) *Functions and players*: in a complex industry, a range of different services are important related to genetics and productivity, herd management and marketing. A key player in the provision of technical guidance for farmers has historically been the National Wool Growers' Association (NGWA), providing services to (fee-paying) members. They also establish standards for the industry. Brokers are the key players in downstream marketing, providing a range of formal (shearing, transporting, baling etc.) and informal (information on price and industry trends) services to producers, and are regulated by an industry body. Government agencies offer services related particularly to animal health and management.

(d) *Systemic constraints*: services have historically been concentrated on commercial farmers and do not work well (or often not at all) for emerging farmers. There appear to be a number of problems here. Emerging farmers (the demand-side) are small-scale and scattered geographically and, without organisation, difficult, expensive and high-risk for providers to serve. Their lack of voice and organisation has not allowed them to articulate an effective demand. Moreover, their knowledge and understanding of services is weak and their existing sources of information inadequate.

On the supply-side, providers' existing practices – geared towards large-scale farmers – are inappropriate for the small-scale and they are unable to see the commercial benefit in serving them. Overall, there is a noticeable *disconnect* between the formal and informal systems that have developed for the mainstream industry and those of emerging farmers.

3. A future picture

Better functioning services markets in the wool industry, improving participation by the poor, may offer the opportunity for increased incomes (prices and output) for a large number of small-scale producers. To achieve this, structural change in terms of functions and players for the main categories of services is not envisaged. The future vision of the industry, however, is one where, first, providers are offering better and more relevant services to emerging farmers and, second, in order to allow this to happen, emerging farmers are better organised to consume, pay for and interact with these supply-side players. In so doing, informal networks and information flow and quality should improve.

4. Actions

In pursuit of this future picture, a range of short-term development activities supported by a development agency could be provided aimed at improving (1) key supply-side players' (such as NGWA, private sector brokers and government agencies) knowledge, capacity and practices and (2) demand-side players' organisation and knowledge of the mainstream industry. This might include activities such as:

- Technical assistance to enhance the “offer” of and incentivise private sector providers of market services
- Establishment of associations, study groups and liaison forums for crime prevention
- Assistance to enhance health management, selection and breeding services from NGWA and government-provided services
- Linkage improvement between commercial breeders and farmers

seen to be a key public role. For vocational skills, however, the picture is less clear. In many countries, it is accepted that private firms will under-invest in training because of the risk that they cannot appropriate all the benefits of trained staff and state assistance is provided. And there are a range of approaches pursued, some involving BMOs. However, it is also the case that, in many economies, skills development is a new, high growth market, with many and varied providers. In this kind of environment, it is important for government to be alive to new requirements and opportunities that may arise with respect to standards, information and co-ordination.

- In many markets, the guise of co-ordination has provided government with a reason for extensive (and often unwelcome) activities. Many markets require no co-ordination! However, in mass and large scale markets affecting many people, where different parties are involved, co-ordination can be useful in providing a clear and shared vision of roles and responsibilities. For example, in financial services, agriculture extension, training, water and other infrastructure, providing certainty over roles shapes incentives and opportunities for the private sector. Government is often uniquely placed to provide this co-ordination.

While the above are all potentially valid in different situations, the role of regulation, supervision and licensing merits particular attention. Many of the examples of how markets can work more effectively for the poor stem from innovative approaches to managing and collaborating with the private sector. Two points are clear from a variety of experiences. First, there are a multiplicity of models of public:private interface and creativity and flexibility is required in developing appropriate models for different situations (Table 4). Second, to develop the most appropriate approaches, governments need knowledge of markets and this remains a capacity challenge.

Table 4: Alternatives to legislation for government³⁵

The UK Government's Department of Trade and Industry lists 18 alternatives to formal legislation.	
• Do nothing	• Recommendation schemes
• Self-regulation	• Working with representative bodies
• Co-regulation	• Pre-market assessment schemes
• Information and education campaigns	• Post-market exclusion measures
• Financial (tax) incentives	• Service charters
• Tradeable permit schemes	• Codes of practice
• Guarantee arrangements	• Standards (voluntary and regulatory)
• Mediation services	• Mandatory audits
• Quality marks	• Ombudsmen

Overall, there are many opportunities for government to play creative and successful roles in MMW4P. However, these are only likely to be realised if government does not allow itself to be wedded to traditional roles which, sometimes, have failed. Importantly, in whatever it chooses to do, government's role has to be transparent and justified with respect to the final goal of poverty reduction.

In practice, especially in considering government's role, strategic considerations merge with operational concerns. How government should play a role in delivering different market functions is beyond the remit of this paper. However, with respect to regulation in particular, there is growing and detailed experience from which to learn. In water, for example, "privatisation" can mean a range of different contractual arrangements and division of responsibilities; there is not one model only (Table 5).

In each case, it is incumbent upon government to develop regulatory regimes that provide incentives for good performance, balancing commercial and social objectives. Weaknesses in regulatory designs and capacities have been the main reason for many of “privatisation’s” performance failings. Indeed, for access to further improve in many countries, even more advanced and creative public:private collaborations will be necessary (Box 6).

Table 5: Forms of private sector participation in the water industry³⁶

Contract type	Service contract	Management contract	Lease	BOT/BOO	Concession contract	Divestiture
Asset Ownership	Public	Public	Public	Public and private	Public	Private or public and private
Capital investment	Public	Public	Public	Private	Private	Private
Commercial risk	Public	Public	Shared	Private	Private	Private
Operations and maintenance	Public and private	Private	Private	Private	Private	Private
Tariff collection	Public	Public/ private	Private	Public	Private	Private
Duration	1-2 years	3-5 years	8-15 years	20-30 years	25-30 years	Indefinite (may be limited by license)

Ultimately, in water (and other services seen as “rights”), universal provision requires subsidy for the poorest. How to provide subsidies in these situations in a manner that reaches the poorest, is not captured by others and does not distort the wider market remains an operational challenge. Demand-side subsidies, directly strengthening consumer’s purchasing power, is perhaps the “cleanest” way of achieving this but there are often major administrative challenges associated with these.

Box 6: Learning from Africa’s experience in the water industry: clear benefits and opportunities^{37 38}

West Africa’s experience with water privatisation is broadly consistent with that of Latin America. Evidence from Guinea, Senegal and Cote d’Ivoire all shows improvement with respect to key performance indicators: connections, unaccounted for water, efficiency, quality and billing. Prices, however, have often increased. A key reason for this lies with the government in its capacity as a consumer (refusing to pay its bills!) and, more importantly, as a regulator. Problems have arisen in some cases because of the nature of the agreement with private companies, and in others because of technical and organisational constraints inhibiting the move from a provider to a regulatory role, for example, misapplying formulas for price adjustment from cost increases. The capacity required to undertake the regulatory task – has been underestimated.

The existence of small, independent water and sanitation service providers in many African countries represents a further challenge and opportunity for governments. Water supply systems for many small towns are too small and scattered for a conventional water company to cover its operating costs. Small-scale providers may offer a viable option for local delivery – if an appropriate mechanism can be created to link them with a large water company and to regulate the arrangement.

In Mali, the water market is moving in this direction. Community water users’ associations are responsible for water delivery in many towns. Since 1994, their performance has improved dramatically (unit costs have fallen by 60%) through fee-based technical and advisory services provided by a water advisory unit. This also conducts performance audits that form an objective and transparent basis for performance comparison and the basis of new contractual arrangements between associations, local authorities and the Water Ministry.

Mini-case 2: Making financial services markets work for the poor in South Africa³⁹

1. Delineating the market

The major categories of service in the financial services market are transaction banking (current accounts, bill-paying, cheques etc.), savings, credit and insurance. These are offered by formal financial services organisations.

2. Understanding the market

(a) *Trends*: the industry has been characterised by tight margins in recent years. High end customer numbers are static. The most likely source of growth in the industry is from new customers, especially the significant number of so-called “emerging consumers” who are being brought “on grid” into the formal economy with housing, mailing addresses, electricity and water. Expectations of improved services among this group, including financial services, are growing.

(b) *The poor and the market*: people participate in the market as consumers. Although numbers vary from one service to another, only approximately 40% of South African adults use financial services. The “unbanked” 60% of the population amounts to around 17 million people. Clearly, the vast majority of poor people do not participate in the market.

(c) *Functions and players*: the industry is dominated by a small number of banks, who compete with each other and develop their own products. Legal regulation is provided by government but, through the industry’s own body – the Banking Council – various performance standards are also set. The Council also represent the industry to government (and others) and co-ordinate with them on its on future path.

(d) *Systemic constraints*: a number of reasons appear to underpin the low level of coverage achieved among low-income groups. In contrast with higher-income groups (where coverage and service levels are high) banks see this as a high risk group with very little of the certainty offered by higher-income customers in the form of information and standards. Product development aimed at low-end consumers has been minimal. More generally, the lack of clarity over the future path of the industry and discussions with government over the Financial Services Charter have clouded future planning. On the demand-side, many potential consumers, with limited exposure to financial services, lack an understanding of the rights and responsibilities inherent in using financial services.

3. A future picture

A more inclusive banking industry offers the prospect of large-scale impact on the poor: extending coverage from 40% to 60% would reach an additional 5 million people. To achieve this, a number of different scenarios are possible for a more inclusive banking industry. That which appears to offer most prospect of success involves a clear allocation of responsibilities between key players. In order to address the core information problem at the heart of the market’s poor performance, the banking industry collectively would develop an “account for life” standard, providing shared information on individual customers. This could then provide the basis for improved product development by banks – drawing on a central fund established by the industry with its own resources.

Government would play an active role in supporting the industry’s efforts to extend to new markets through a number of specific roles: a large-scale programme of public education for this new consumer group would be delivered along with more appropriate regulation of the industry, including suitable licensing and supervision of new banking organisations; a new consumer credit law and enhanced monitoring of access performance.

4. Actions

This shared vision of the future would provide the basis for a number of specific and complementary actions by the key players: government, the industry as a whole, and individual financial services providers – as well as development agencies acting in support of these. A range of activities might be envisaged, for example:

- Research on consumer awareness and understanding of financial services
- On this basis, a substantial consumer information and education campaign
- Development of the modus operandi of a product development innovation fund
- Development of industry-wide standards for low income customers including the operational basis for information sharing
- In support of new and appropriate licensing and consumer credit regulations, major steps to enhance the capacity of suitable government offices and personnel.

Whatever strategic and operational decisions are made, assessing the value of MMW4P approaches can be assessed with three main sets of impact indicators.

- *Market delivery* (“supply-side”) indicators: these are concerned with the performance - costs and efficiency - of delivering various market functions, including financial performance, operational deliverables versus targets and number of providers.
- *Market participation* indicators: the core set of indicators should relate to poor people’s direct experience of markets:

From a *consumer perspective*: use of services/consumption of products: access and expenditure of the poor relative to other groups; perception of services/products: experience of services/products – trends in satisfaction and attitudes – again relative to other consumer groups

From a *producer perspective*: prices and margins relative to other groups
- *Market benefit* indicators: improved access to goods and services and improved prices and margins can normally be taken to be proxy indicators of poverty-reducing benefit. Direct benefit indicators might include those associated with household incomes, health and education.

4.4 Building from analysis to actions

The preceding steps should provide the platform for action:

- a) A clear delineation of the market in question;
- b) An understanding of the market in relation to:
 - market trends (the bigger picture)
 - the existing participation of the poor
 - key players and functions
 - underlying systemic constraints that impinge upon the market’s development
- c) A vision of how the market can operate more effectively in the future in relation to the:
 - strategic picture of functions and players (who does and who pays); and
 - operational picture of how roles are performed.

Logically, then, having developed a picture (b) where the market is and (c) where should it be, organisations need to consider steps required to get there (i.e. overcoming critical constraints to go from (b) to (c)).

This paper cannot delve into the minutiae of the specific activities organisations can take to translate analysis into actions. Clearly these will vary depending on the market, organisation, their core competence and their capacity.

In all cases, however, prior to embarking on the implementation task, the immediate challenge for organisations seeking to make sense of a commitment to making markets work more inclusively is to consider what their distinctive role should be, to agree this role with other market players, and in doing so, develop a shared view of how markets could work more effectively in the future.

5. Conclusion

This paper has sought to make two complementary points.

First, there is a strong rationale for MMW4P to be a key objective for governments and development agencies. Countries that have been most successful in reducing poverty have done so because they have been able to draw on the essence of markets in creating systems that are conducive to growth and the range of related services that contribute to poverty reduction. Making markets work more effectively for the poor in all cases involves identifying and addressing key systemic constraints that inhibit access – from which benefits can be derived.

Second, making sense of MMW4P, turning commitment into hard reality, requires consideration of a number of general steps all of which require a nuanced view of how markets work in practice. These steps involve building a detailed and informed view of current market performance and operations - including the position of the poor, the existing structure of functions and players and underlying systemic constraints; building a picture of future market performance and sustainability; and developing actions in pursuit of this view of the future.

No policy prescriptions are offered here, no action plans proposed or “how to” checklists specified. MMW4P, as has been emphasised throughout, does not lend itself to snappy formula – indeed it grows from the (failed) development experience of superficial analysis and actions. Turning MMW4P from interesting idea to practical actions is the next challenge for organisations and requires, inescapably, that attention is turned to gaining a better understanding of markets and the poor and, critically, of the role organisations can play in making the former work for the latter.

Annex 1: Conceptual issues in understanding markets^g 40

Definition and context

Markets are a concept central to economics. In general, markets can be regarded as a set of arrangements by which buyers and sellers are in contact to exchange goods or services; they are thus a means by which the decisions of producers and consumers are reconciled through the adjustment of prices. Fourie's definition⁴¹ of market exchange as an "economically qualified purposeful interchange of commodities on the basis of *quid pro quo* obligations at a mutually agreed upon exchange rate in a cluster of exchange and rivalry relations" highlights important market characteristics of mutuality (of agreement if not always benefit) within a framework of competition. Despite their centrality, there exists considerable debate (and disagreement) over the nature of markets, especially over the extent to which theoretical constructs illuminate reality.

According to mainstream economics, markets operating in the above manner are associated with efficiency and welfare properties. However, this rests upon a series of assumptions, most importantly perfect competition and perfect information. That these assumptions are unrealistic has always been accepted but the scale of their significance has tended to be underestimated – or "assumed away". Discomfiture with such "liberties with reality" has fuelled occasional talk of "crisis" in economics (as a discipline) over the last 20 years reinforced by its palpable failure to predict shocks and provide convincing explanations for fundamental economic problems, including the persistence of poverty⁴². The emphasis on mathematical models in economics – usually built on similar assumptions – has also been criticised for furthering its flight from relevance, making it a "means to escape from reality rather than a tool to help understand it"⁴³.

One key problem, the relative neglect of information in markets, has been highlighted by the economics of information⁴⁴. This illustrates how the development of markets (especially insurance markets) can be shaped by pervasive problems of moral hazard and adverse selection resulting from imperfect information. While there are no specific policy prescriptions arising from this realisation of the importance of information, one clear implication is that public agencies need at least to have a good understanding of information asymmetries in a given situation.

The importance of the institutional environment

Notwithstanding information problems, mainstream economics still regards price signals as being the critical determinant of market decision-making. Yet, even within a market economy, it is clear that people's behaviour is driven by a wider set of issues and actors - households, governments and firms – and not simply by prices. The rise in New Institutional Economics (NIE) in recent years – concurrent with and prompted by development experience – is a recognition of the complexity of real world factors – where " the realms of state and market, public political and economic systems, are densely and inextricably intertwined"⁴⁵ - that impinge upon decision-making. For example, the apparent failure of macro-economic policy orthodoxy to stimulate a vigorous supply-side response in many countries, it has been argued, can be explained by the failure to contextualise appropriately and take cognisance of *institutional* realities.

Institutions are "sets of rules that are recognised and frequently followed by members of the community and that impose constraints on the actions of individual members". They are "rules of the game" that shape people's incentives and behaviour and thus

^g This annex draws on Annex 1 of the DFID framework paper "Making markets work for the poor" (2000)

comprise not simply formal laws and regulations, enforcement mechanisms and organisational procedures but – as important – informal rules arising from cultural norms and practices. In the context of markets, transactions between demand and supply side players are dependent on “a third party to exchanges, namely government, which specifies property rights and enforces contracts and second on the existence of norms of behaviour to constrain parties in interaction”; ie dependent on institutions to create a conducive market environment⁴⁶.

Development experience in recent years is replete with examples illustrating the importance of institutions for market development. The differing performance of transition economies – often with relatively developed infrastructure and human resources – has been attributed to the relative efficacy of different institutional environments. In many other low-income countries, supply-side response to macro-level reforms appears to have been undermined by the absence of mechanisms for handling risk and contract enforcement. In Africa in particular, widespread institutional *discontinuity* – manifested in inappropriate rules, regulations and networks – is seen to have inhibited development while the success of other countries (eg Botswana) has been attributed to good institutions.

The perceived importance of institutions as the “deep determinants of development” has grown considerably in recent years. For an increasing number of economists, institutions occupy a position of primacy in explaining countries’ differing performance. Assessing different potential explanations, Rodrik and Subramanian’s conclusions are very clear, “the quality of institutions is the only positive and significant determinant of income levels”⁴⁷. Since institutions are “socially devised”, rather than predetermined *givens*, these conclusions appear to offer hope and opportunity for the cause of development.

..... with some caveats

However, amidst this growing momentum towards institutions as the key to economic development, voices of caution (and disagreement) are evident. Sachs⁴⁸ maintains that geographic factors – such as natural endowments and peripherality of location – are also critically important and warns against the (apparent) view that “institutions explain nearly everything” and of the risks of the “institutions-only argument”. Toye highlights the dangers of elevating “a useful low-level theory until it becomes an unsuccessful global-historical generalisation”⁴⁹.

One key point of concern for critics of NIE is its apparent “emptiness”. While acknowledging the importance of institutions, it is less clear what should be done with this? What policy prescriptions emerge from it? In acknowledging that institutional models do not necessarily travel well from one context to another, it is less clear what is being advocated. Where is the efficacy of the institutional development message?

Giving meaning to markets as institutions

An underpinning concern here is the apparent “vagueness” and somewhat nebulous nature of institutions^h. However, there are increasing attempts at bringing tighter definition to institutions. The effectiveness of institutions has been defined in terms of “the quality of governance (including the degree of corruption, political rights, public sector efficiency, and regulatory burdens); the extent of legal protection of private property (and how well such laws are enforced), and the limits placed on political leaders”⁵⁰. Others have developed composite indexes that seek to measure aggregate governance and constraints on the executive⁵¹.

^h Terminology may not help the cause of clarity. In particular, “institutions” is often seen as synonymous with “organisations”.

In the context of markets, institutions refer particularly to the “regulatory framework”, the set of rules and actions that guide market participants. There are four main requirements of a regulatory framework for a market system to function^{52 53}:

- A set of “ordered relations” between economic agents established by legal and social conventions that define and allocate property rights, entitlements, and delineate the scope of economic behaviour.
- Rules about transactions between economic individuals that define processes for exchange of property rights, what constitutes legitimate contracts, permissible and non-permissible forms of co-operation and competition, and rules on liability.
- A system of legitimate authority to enforce rules, including penalties for delinquency
- Mechanisms by which rules can be adapted to changing economic and social circumstances while providing a predictable framework for market participants.

While the state may play a role in developing a regulatory framework, other organisations (such as representative business associations) and formal and informal mechanisms can also be important. Indeed, it has been argued that the most successful market systems are built on generalised social norms with minimal resort to legal enforcement⁵⁴. In general, as economies become more complex, regulatory frameworks become more formalised and, with increasing trade, international.

Overall, however, while there is growing awareness of the *general* nature of the systems that help markets to perform more effectively, there is much little useful specific guidance on *how to* contextualise this within specific market situations¹. “Giving meaning” to institutional development in markets therefore does inevitably involve engaging with local market situations and (learning from wider experience), applying principles to practical reality.

The above issues relating to how markets develop impinge on the poor generally - as they do on the wider population – both directly as participants in markets (as consumers or producers) and indirectly through the economic growth generated when markets function effectively. Transaction costs for the poor, however, are particularly high.

Market development which is especially pro-poor in outcomes is likely to be characterised by:

- Identifying and addressing constraints that are notably severe for the poor. For example, the poor’s exclusion from: tight-knit market networks and the norms and information around these, resource distribution through administrative allocative mechanisms (eg for land), the benefits of insider protection in the labour market; and the service markets in which providers have historically not focused on them and are therefore unaware of how to reach them. In each case, specific constraints (impacting disproportionately on the poor) can be addressed.
- Focusing on markets *where the poor are* present in significant numbers. As producers, this might include agricultural markets, as consumers, financial services and as labour market participants (producers) labour intensive sectors.
- Focusing on markets that allow improved risk management, for example improving land transferability should allow better access to collateral-based finance. Improving business networks should allow better information flows to anticipate and plan for market change.

¹ The framework of market functions and players connected by considerations of provision and payment seeks to give specific, practical meaning to institutional development for particular markets

References

- ¹ OECD (2001); *The DAC Guidelines: Poverty Reduction*, Paris
- ² World Bank (2003); *Global economic prospects and the developing countries*; Washington DC
- ³ Dollar, D. and Kraay, A. (2002); *Growth is good for the poor*, World Bank, Washington DC
- ⁴ NEPAD (2003); *A summary of NEPAD action plans*.
- ⁵ Bhalla, S.J. (2002); *Imagine there's no country: poverty, inequality and growth in the era of globalisation*; Institute for International Economics, Washington DC
- ⁶ National Family and Health Survey-2 (1998-99) – quoted in World Bank (2003); *Making services work for poor people*; Oxford University Press
- ⁷ World Bank (2003); *Making services work for poor people*; Oxford University Press
- ⁸ Stiglitz, J (2002); *Globalisation and its discontents*; Penguin
- ⁹ World Bank (2003); Questions and answers with David Dollar at www.worldbank.org/economicpolicy/globalisation
- ¹⁰ North, D.C.(1990); *Institutions, institutional change and economic performance*; Cambridge University Press
- ¹¹ Ferrand, D. V.(1999); *Discontinuity in development: Kenya's middle-scale manufacturing industry*, PhD Thesis, University of Durham
- ¹² King, K and McGrath, S (1999); *Enterprise in Africa: between poverty and growth*; ITDG Publishing
- ¹³ Hatch, C.R. (2003); *Cluster/network strategies for microenterprises development: lessons from microenterprise best practices project action research in India, 2000-01*; USAID
- ¹⁴ Gibson, A (1999); *The development of markets for business development services*; in Levitsky, J. (ed.) (2001) *Small business services in Asian countries*, ITDG Publishing
- ¹⁵ De Soto, H. (2000); *The mystery of capital. Why capitalism triumphs in the west and fails everywhere else*; Basic Books, New York
- ¹⁶ McKenzie, D. and Mookherjee, D. (2002) *Distributive impact of privatisation in Latin America: an overview of evidence from four countries*, Overview of a research project commissioned by the IADB and sponsored further by the Universidad de las Américas-Puebla.
- ¹⁷ Klein, N. (2000); *No logo*; Flamingo Publishers, London
- ¹⁸ Lipton, M (1986); *Capitalism and apartheid*; Gower
- ¹⁹ Paul-Majumder, P and Begum, A. (2000); *The gender imbalances in the export oriented garment industry in Bangladesh*; Policy Research Report on Gender and Development, Working Paper Series No. 12, The World Bank Development Research Group
- ²⁰ Kabeer, N. (2003); in *Globalisation and employment: working for the poor*, id21 insights, Institute of Development Studies, UK

-
- ²¹ Anderson, G. (2004); *Radio media in Africa: a market development tool for business services*; unpublished final project report funded under DFID's Enterprise Development Innovation Fund
- ²² White, D. (2003); *How Africa joined the new wireless world*, The Financial Times (UK), 27/11/03.
- ²³ Navas-Sabater, J, Dymond, A, Juntunen, N (2002) *Telecommunications and information services for the poor – toward a strategy for universal access*, World Bank Discussion Paper no.432
- ²⁴ Rutkowski, J. (2003), *Does Strict Employment Protection Discourage Job Creation? - Evidence from Croatia*, World Bank Policy Research Working Paper 3104
- ²⁵ Government of South Africa (2003); *South Africa's economic transformation: a strategy for broad-based black economic empowerment*; South Africa
- ²⁶ Deininger, Jin et al (2003); *Market and non-market transfers of land in Ethiopia – implications for efficiency, equity and non-farm development*; World Bank Policy Research Paper 2992
- ²⁷ Do, Quy-Toan & Iyer, Lakshmi (2003); *Land rights and economic development – evidence from Vietnam*; World Bank Policy Research Paper 3120
- ²⁸ Deininger, K. and Jin, S. (2002); *Land rental markets as an alternative to government reallocation? - equity and efficiency considerations in the Chinese land tenure system*; World Bank Policy Research Working Paper 2930
- ²⁹ Meerman, J. (1997); *Reforming agriculture: the World Bank goes to market*; World Bank Operations Evaluation Department
- ³⁰ Committee of Donor Agencies for Small Enterprise Development (2001); *Business development services for small enterprises: guiding principles for donor intervention*; at www.ilo.org/public/english/employment/ent/sed/bds/donor/member/ilo.htm
- ³¹ Mills, A et al (2002); *Approaches for improving service delivery in the non state sector: what is the evidence on what works, where and why?*; paper funded by DFID as consultation input for the "Making Services Work for the Poor" World Development Report (WDR) 2003/04
- ³² Bear, M., Gibson, A. and Hitchins, R. (2001); *A guide for agencies on the emerging market development approach to BDS; Microenterprise Best Practices, Technical Note 2*, Washington DC
- ³³ Lusby, F. and Eiligmann, A (2004); *Promotion of embedded business services for small enterprises in the Ghanaian craft export sector*; unpublished final project report funded under DFID's Enterprise Development Innovation Fund
- ³⁴ The ComMark Trust (2003); *South African wool subsector analysis*; unpublished paper prepared for ComMark' wool intervention strategy development
- ³⁵ Regulatory Impact Unit, (2003); *Better Policy Making – a guide to regulatory impact assessment*; UK Government Cabinet Office
- ³⁶ Mehta, L. and La Cour Madsen, B. (2003); *Is the WTO after Your Water – the General agreement on trade and services (GATS) and the basic right to water*; Institute of Development Studies, UK
- ³⁷ Collignon, B. and Vézina, M. (2000); *Independent Water and Sanitation Providers in African Cities – Full Report of a Ten Country Study*; published under the UNDP-World Bank Water and Sanitation Program

-
- ³⁸ Bayliss, K. (2001); *Water privatisation in Africa: lessons from three case studies*; Public Services International Research Unit, University of Greenwich
- ³⁹ The FinMark Trust (2003); *Vision 2010. Scenarios of the South African financial system*.
- ⁴⁰ DFID (2000); *Making markets work for the poor; a framework paper*, DFID, November 2000.
- ⁴¹ Harris-White, B. (ed.) (1999); *Agricultural markets from theory to practice*; MacMillan
- ⁴² Ormerod, P. (1994); *The death of economics*; Faber and Faber, London
- ⁴³ Hodgson, G.M. (1999); *Evolution and institutions*; Edward Elgar, Cheltenham, UK
- ⁴⁴ Stiglitz, J. (1994); *Whither socialism?*; The MIT Press
- ⁴⁵ White, G. (ed.) (1993); *The political analysis of markets*; IDS Bulletin 24(3)
- ⁴⁶ North, D.C. (1989); *Institutions and economic growth: an historical perspective*; World Development Vol. 17 No. 9. 1319-1332
- ⁴⁷ Rodrik, D. and Subramanian, A. and Trebbi, F. (2002); *Institutions rule: the primacy of institutions over geography and integration in economic development*; NBER Working Paper 9305, Cambridge MA
- ⁴⁸ Sachs, J.D. (2003); *Institutions don't rule: direct effects of geography on per capita income*; NBER Working Paper 9490, Cambridge MA
- ⁴⁹ Toye, J. (1995); *The New Institutional Economics and its implications for development theory*; in Harriss, J and Lewis, C.M.(1995); *The New Institutional Economics and Third World development*; Routledge, London
- ⁵⁰ Edison, H. (2003); *Testing the links. How strong are the links between institutional quality and economic performance?*; Finance and Development, June 2003
- ⁵¹ Kaufman, D, Kraay, A. and Zoido-Lobaton, P. (1999); *Aggregating governance indicators*; World Bank Policy Research Working Paper, 2196; Washington DC
- ⁵² Bromley, D.W. (1993); *Reconstituting economic systems: institutions in national economic development*; Development Policy Review, 11, 131-151
- ⁵³ Shaffer, J. (1980); *Food system organisation and performance: towards a conceptual framework*; American Journal of Agricultural Economics, Vol 61(2), 723-31
- ⁵⁴ Platteu, J-P (1994); *Behind the market stage where real societies exist – part 1: the role of public and private order institutions*; Journal of Development Studies, 30(3), 533-577