Making Markets Work Better for the Poor: The Framework

1. Introduction

The objective of all interventions in support of private sector development (PSD) should be to bolster growth and improve the livelihoods of the poor, a powerful combination that is proven to be the most effective way of reducing income poverty sustainably. For instance, during the 1980s, China experienced one of the fastest reductions in income poverty that the world has ever seen with over 200 million people escaping poverty. The household responsibility system[1] spurred the growth of agriculture and increased the incomes of farmers whilst the growth of manufacturing in townships and villages contributed to stronger industrial growth and provided more and better paid jobs for the rural poor.

Since 2000, DFID has been piloting a new framework for analysis and action, making markets work better for the poor (MMW4P), which holds considerable promise as an instrument for contributing to growth and improving the livelihoods of the poor. Many of the early MMW4P programmes achieved notable successes. For example[2]: the FinMark Trust supported the country's financial sector to serve millions of the previously un-banked in South Africa; ComMark Trust supported Lesotho's apparel industry to meet the challenge of losing preferential access to world markets turning the potentially disastrous consequences for the country's major employer and source of exports in to a net gain in jobs and exports. Katalyst in Bangladesh has helped improve the lives of tens of thousands of farmers in some of the poorest areas of Bangladesh and the Employment Promotion Programme (EPP) is helping to reduce the barriers to job creation in South Africa. Because these interventions adopted a market based approach, they have not had to rely on continued intervention to sustain impact.

These achievements have prompted DFID and several other donors to explore the possibility of scaling up the application of the framework and making it an integral part of growth and PSD portfolios across the developing countries. The challenges of accelerating growth and improving the livelihoods of the poor sustainably, through a market based approach, are formidable. Further, the MMW4P framework represents evolving thinking incorporating new approaches to PSD, such as a market based approach to strengthening the capabilities of business, with tools from other disciplines such as rural livelihoods (the sustainable livelihoods framework), social development (gender, social cohesion), governance (drivers of change) and environmental sustainability.

Therefore, there is much to be gained by taking stock of the successes and failures of the early MMW4P programmes, examining how the evolving thinking has worked in practice and learning lessons that may help to inform the scaling up and broader application of the framework. This is what this series of six notes attempts: note 1 addresses MMW4P: Growth and Poverty Reduction; note 2: Integrating Growth Strategies; note 4: Understanding the Market System; note 5: Implementing MMW4P Programmes; and note 6: Lessons Learnt. This note 3 describes the framework and how it may be used to promote growth and improve the livelihoods of the poor.

2. Why is it Needed?

The framework is a response to the mounting evidence of the central role that markets play in promoting shared growth[3]. As the central organising principle of economic activity, markets determine what gets produced and consumed, in what quantity and where and who gets what out of economic activity. Market outcomes therefore influence both the pace of growth and the extent to which the pattern of growth enables the poor to participate in and benefit from the growth process. This is why outcomes of financial, labour, land and agricultural markets, to name a few, have been

[1] The household responsibility system was the reform introduced that enabled Chinese farming households to farm and market the output of a proportion of the land without participating in the collective farming system and free from state control of prices. Manufacturing in rural areas increased during the 1980s when the Government allowed local governments to invest in Township and Village Enterprises (TVEs).

[2] An outline of the early MMW4P programmes and their achievements is appended to Note 6: Lessons Leant.

[3] Used here to mean pro-poor growth defined as 'a pace and pattern of growth that enables the poor to participate in, contribute to and benefit from growth. Promoting Pro-poor Growth, OECD DAC, 2006

found to be causal factors in growth and the incomes of the poor[4].

Markets are the means through which people participate in economic activity. They can do so as producers (farmers, entrepreneurs), as providers of labour (employees) and as consumers of goods and services. When markets operate in an inclusive manner, they serve all participants, including the poor, by offering them the things they need to increase their incomes and meet their consumption needs jobs, new opportunities to earn income, access to assets to improve their livelihoods, products to consume that they can afford. Markets thus provide people with the means to contribute to and benefit from the growth process. Conversely, where markets exclude or disadvantage people, especially the poor, they have fewer chances to participate in and benefit from economic growth[5].

As opposed to the assumption in classical economics that the conditions for perfect competition exist in all markets, in real life, and especially in the developing countries, markets often fail to function in either an efficient or inclusive manner. This may be due to a wide variety of reasons. Some of these are intrinsic to the functioning of markets themselves (market failures)[6]. Others are caused by government failing to discharge its role of ensuring an enabling environment and setting appropriate rules for markets to function, providing the infrastructure and other public goods needed and to correct for market failures (government failure).

When markets fail, market opportunities are frequently captured by the privileged few rather than open to the many, based on their talent and abilities, thus undermining growth. Moreover, when markets fail, their outcomes are often determined by power and wealth, disadvantaging the poor in participating in and benefiting from the growth process[7]. MMW4P provides a framework that can help to improve the functioning of markets and the fairness of their outcomes.

3. Avoiding the Pitfalls of the Past

In the past, when markets failed, governments frequently attempted to suppress the functioning of markets, imposing price controls or providing goods and services themselves. This frequently failed to benefit the poor, reducing the supply or increasing the price of goods and services and allocating the limited supply on the basis of political patronage. During the 1990s, at the instigation of the international financial institutions (IFIs), markets were liberalised with mixed success. Whilst some markets were able to function more efficiently, in others, especially in rural areas where the poor are concentrated, the old market failures resurfaced. Liberalisation paid little heed to the political, economic and social realities that enable vested interest to capture markets and disadvantage the poor.

The MMW4P framework enables a more informed approach to markets that is different from and avoids the pitfalls of previous extreme approaches of either state control or liberalisation. What MMW4P interventions seek to do is to follow Amartya Sen's suggestion that equitable growth '*be dealt with not by suppressing markets, but by allowing them to function better and with greater fairness, and with adequate supplementation*'[8].

4. Basic Principles

The MMW4P framework aims to make markets function better and with greater fairness for the poor men and women that participate in them guided by the following principles:

- When markets function well and fairly, they are the most powerful way of driving growth and reducing poverty sustainably
- In the developing countries markets often do not function efficiently or fairly limiting growth and the opportunities to participate in and benefit from the growth process- and the poor often suffer the most as a result
- Markets are complex mechanisms; they do not work by themselves. They require an enabling environment in which to function, rules and mechanisms to enable efficient exchange and a structure of participation that enables effective competition
- Government has a critical role to play in

[4] The evidence for financial sector deepening is presented in: Finance, Inequality and Poverty: Beck, Demigurc-Kunt, Levine, 2004; for formal employment, in The Nexus of Economic Growth, Employment and Poverty, Islam R, 2004; for land in The Mystery of Capital, Hernando De Soto, 2003; for agriculture in Pro-Poor Growth in the 1990s, World Bank, 2005.

[5] Adapted from Making Markets Work for the Poor: An Objective and an Approach for Government and Development Agencies Alan Gibson, Hugh Scott and David Ferrand, July 2004

[6] A list of the common market failures and how they may be addressed is presented in Annex A below.

[7] World Development Report, World Bank, 2006.

[8] Development As Freedom, Sen A.K, 2001

ensuring markets function efficiently and equitably. Donors may support governments in discharging their responsibility

- Altering incentives for private participants can help to make markets function better. Reducing the barriers that the poor face in participating in markets can help to make outcomes pro-poor. Donors may help in this process working with the private sector and representatives of the poor
- The way that interventions are implemented, in the public and private sectors, should seek to strengthen rather than undermine the functioning of the market providing the incentive for the private sector to increase access to markets for the poor rather than the public sector attempting to provide the service itself or to impose controls on prices and quantities produced
- The majority of the poor have the potential to be lifted out of poverty directly by well functioning markets and indirectly through the growth they generate
- Some of the poor may remain unable to participate and benefit from markets because they live in areas where markets are unviable, lack the assets needed to participate in markets or their vulnerability to risk prevent them from taking advantage of opportunities that markets provide. For such poor, social protection may be needed to lift them out of poverty.

5. What Markets to Address?

In using the MMW4P framework, the selection of markets to address is crucial for success. Analysis will be required to assess which markets have the potential to make a significant impact on growth and the incomes of the poor and provide favourable conditions for interventions to succeed, based on three criteria: **i) the potential for large impacts.** In general, the markets for land, labour, finance (factor markets), agriculture, industrial and service sectors that can contribute strongly to growth and job creation and to meet basic consumption needs, are likely to prove worthy of consideration, but the selection needs to be informed by the growth and poverty experience of the country, as set out in Note 2: MMW4P's Role in Growth Strategies; **ii) feasible timescale for delivering results.** Whether the causes of markets not functioning well or the disadvantage suffered by the poor may be addressed in the short to medium term (3-5 years); iii) **the extent to which conditions are favourable for success** close to the 'perfect storm'[9] of strong policy or market forces that demand change and capable and committed market participants willing to respond to them.

Markets that meet all three criteria are an ideal and it is unlikely in the real world that there will be many that meet all three in full. In particular, all the circumstances that make up the 'perfect storm' may not be present. In some cases, programme designers may have to bring them about by providing evidence to trigger a response from market participants or building the capacity of legitimate and credible stakeholders to enable them to respond. The analysis required to establish the extent to which markets meet the three criteria is time intensive and may be contracted out. In many instances, however, the analysis may not provide clear cut answers on whether to go ahead with an MMW4P intervention or not. Programme proposers and designers will often need to make a judgement call as to whether to proceed, weighing up potential rewards against risks.

6. Identifying the Problem

Having short listed the markets, the next step is to assess what is the problem that needs fixing by assessing the extent to which the market is functioning well and fairly. The characteristics to look for are:

1. **Growing rapidly, deepening and offering choice**. With few exceptions[10], well functioning markets should be growing at least as fast as the growth in average incomes or, where appropriate, the growth of international markets. And, well functioning markets should be deepening (becoming more complete), pushing forward the access frontier[11] to include more participants, especially the poor. And, they should offer choice to participants so that they may make up their own mind on what and how to buy or sell.

2. **Becoming more efficient, competitive and innovating.** Well functioning markets should become more efficient, reducing the costs of production and exchange, and hence make products more affordable. It is important for efficiency that market signals, or particular agents, co-ordinate the disparate activities of

[9] A full description of the conditions that make for a perfect storm is appended in Annex B.
[10] Demand for some products, known as inferior or Giffen goods, does not increase with incomes.
[11] Defined as the ability of the market to meet demand from the poorest buyers profitability, given current infrastructure and technology.

the many players involved in performing the multiple functions needed to meet buyer needs. Competition, the spur to new ways of producing or marketing products, is a pre-requisite for a well functioning market. Without it, markets maybe captured by a few who will then have the incentive to earn rents by restricting supply. Innovation, to find better ways of meeting customer needs and the offer of choice to buyers and sellers, is a key indicator of a well functioning market.

3. **Provide a level playing field in terms of information, access and reaping benefits**. Information on what buyers need and sellers are offering should be widely available so that individual participants can exercise choice effectively thereby helping the market to become more efficient (reducing transaction costs). Markets should, as far as possible, be accessible to all and there should be a level playing field in terms of access with no one excluded or disadvantaged by their small size (indivisibility) or membership of particular social groups. This is likely to call for an assessment of how the poor participate in the market as producers, employees and consumers, and an analysis of the causes of why the poor are disadvantaged in accessing and benefiting from the market.

Even if all three criteria above are met, analysis of how the poor are participating in markets may throw up the need to supplement their assets, address their vulnerability or reduce the disadvantage they face through poor access to infrastructure or remote location. The way that such supplementation is done, however, should seek to strengthen rather than undermine market functioning, as discussed in section 5, Note 4.

Through understanding a) what is constraining markets from growing and becoming more inclusive; b) what needs to be in place to enable markets to function efficiently and competitively; and c) understanding the extent to which there is level playing field and the poor are able to access and benefit from markets, the framework is able to guide the focus of interventions that will make markets work better and more fairly for the poor.