

CKPIM BUSINESS REVIEW



Making Market Systems Work Better for the Poor (M4P): A sustainable Approach

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Introduction

With only a decade left to achieve the Millennium Development Goal of halving the number of people living under one dollar a day, increasing attention must be paid to the rate of growth of the incomes of the poor. The effective operation of markets plays an important growth-enhancing role by creating incentives for investment and trade, and by allocating resources within the economy. But cross-country evidence also shows tremendous variations in the extent to which incomes of the poor increase as a result of growth. In other words, the pattern of growth is important for poverty reduction too. The participation of the poor in markets and the terms of their participation are critical determinants of whether growth is pro poor. A better understanding of the role of markets in generating pro-poor growth will help formulate more effective policies and programmes to reduce poverty.

Traditionally, when market outcomes have not been pro-poor, the response has been for governments – on their own or supported by donors – to provide goods and services themselves. Often, the result of this intervention is to distort markets and ‘crowd out’ the private sector. And because Government and donor resources are limited, these direct interventions have either failed to meet the needs of the poor, or have generated temporary and unsustainable supply. In the worst-case scenarios, the supply of the good or service becomes a form of patronage.

This paper provides an introduction to an emerging framework for Making Market Systems Work Better For The Poor (M4P2). The framework builds on recent approaches to providing goods and services for the poor through market systems, and summarises much of the recent thinking on how to provide assistance to the private sector. M4P can be understood in three ways: (1) as a development objective; (2) as a framework for analysis and understanding; and (3) as a practical framework for action.

Importance of Making Market Systems Work Better for the Poor (M4P)

Markets, when they work, can be an efficient mechanism for the exchange, coordination and allocation of resources, goods and services in an economy. Well-functioning markets that support competition and lower the costs of doing business provide incentives for trade and investment, and hence growth and poverty reduction. Markets are the main ‘transmission mechanisms’ between growth in the wider economy and the lives of the poor. They are important for poor remote areas

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because of the linkages they offer between the local economy and the national and global economies. The way markets function will determine the rate and pattern of growth and, consequently, the speed and extent of poverty reduction.

But markets may also fail, and in particular fail the poor. In the specific context of poor rural areas, or in the development of new products or services, markets may be too 'thin'. The risks and costs of participating in markets may be too high. In other cases, social or economic barriers may mean that the poor, or specific groups, such as ethnic or religious minorities, are excluded from markets.

Governments have long recognised that market outcomes may not be pro-poor and have sought to intervene in markets. Unfortunately, traditional approaches to make markets work better frequently make things worse. This is because distortions are introduced that impair the efficiency of resource use and undermine growth. These distortions may reduce incentives for the private sector to grow and invest, and may not meet the needs of the poor.

M4P is such an approach. It aims to accelerate pro-poor growth by improving outcomes that matter to the poor in their roles as entrepreneurs, employees or consumers of markets. M4P focuses on changing the structure and characteristics of markets to increase participation by the poor on terms that are of benefit to them. It addresses the behaviour of the private sector and therefore reinforces the strengths of market systems, rather than undermining these systems. In this way, M4P is based on recent thinking about how to use market systems to meet the needs of the poor and how to support the private sector through market mechanisms that bring about sustainable change.

Making Market Systems Work Better for the Poor (M4P)

Theoretical Context

It is widely recognised that efficient markets play an important role in generating economic growth. They provide a way to allocate resources that ensures the highest value of production and maximum consumer satisfaction. Elaborations of neo-classical economics demonstrate that perfectly competitive markets lead to an optimal allocation of resources, where it is impossible to improve anybody's welfare through changes in production or exchange without worsening someone else's welfare. However, there are two main caveats:

- 1) Perfectly competitive markets are hardly ever found in the real world – particularly in developing countries.
- 2) Well-functioning (efficient) markets can co-exist with widespread poverty, since distributional and equity issues are not directly dealt with by the market.

The starting point for M4P is the work of New Institutional Economics (NIE). The NIE approach questions the relevance of the assumption of a perfectly competitive market, noting that information is incomplete, asymmetrical, costly to acquire and costly to use. Poor information introduces risks in undertaking transactions. Transaction costs must then be incurred to acquire information and provide protection against these risks, and market players must make decisions that allow for these risks and costs. Institutions – 'rules of the game' – exist and evolve to reduce transaction costs and risks. An NIE definition of a market is framed by this understanding: 'Markets are institutions that exist to facilitate exchange; that is, they exist in order to reduce the cost and risk of carrying out transactions' (cited in Porteous 2004).

In addition to NIE, other related work also focuses on how markets provide solutions to traditional development problems. The World Bank has supported work on housing provision that shows how it is possible to introduce incentives that will encourage the private sector to provide for the needs of the poor. The Consultative Group to Assist the Poor (CGAP) has shifted attention from direct support to microfinance institutions to an approach of mainstreaming microfinance into the financial market system as a whole. Michael Porter's work on value chains and subsequent work on global value chains attempts to understand the way market forces work to influence returns to the various participants in international commodity chains (Porter 1998).

Recent work on how private sector development contributes to pro-poor growth indicates that it is not the type or size of enterprise that is important for achieving pro-poor growth. Pro-poor market outcomes can be generated by both small and large enterprises. What is more important is the operation of the overall market system to produce pro-poor outcomes.

Reflecting these findings, donor support for enterprise development is changing from direct support to individual enterprises to support for the development of markets for business services. These trends are reflected, for example, in the Small to Medium Enterprises (SME) Donor Committee 'Blue Book' and the International Labour Organisation (ILO) 'Primer' on Business Development Services.

The Original M4P framework

Much of this new thinking was brought together in the late 1990s in 'Making Markets Work Better for the Poor' (DFID/OPM 2000). The original M4P framework encourages better analysis and understanding of the role of markets in achieving pro-poor growth in order to identify ways of strengthening the pro-poor functioning of markets and to guide policy formulation. The framework considers markets for goods and services, and factors of production, and focuses particularly on credit, land, labour and staple foods, as these are the basic markets in which the poor are either directly involved – or could more directly benefit from participation in. The framework sets out how markets can work better for the poor through assisting broadly-based growth.

The original framework combines an analysis of poverty based on the Sustainable

Livelihoods (SL) model with an analysis of the functioning of markets based on insights from NIE. The SL model highlights the importance of poor people's access to physical, natural, human, social and financial assets, and the returns they get from those assets. Markets provide opportunities to get better returns from assets and to obtain new assets through exchange. The NIE analysis of markets emphasises the role of institutions and the level of 'transactions costs' in influencing economic behaviour and pro-poor market development. In this perspective, markets themselves are an institution with sets of rules that govern exchanges for value between buyers and sellers.

For markets to work better for poor people, they must provide access to the opportunity to build and acquire assets, and help to reduce vulnerability. To do this, markets must become progressively more developed, more complete and more accessible to poor people. Market development can contribute to enhancing growth, empowerment, opportunity and security in a variety of ways and through a range of mechanisms (some of which are illustrated in Table 1).

The development of market institutions will increase growth rates by lowering transaction costs³, enabling more types of goods and services to be bought and sold, and allowing prices to reflect scarcity and information. Improved access to markets and services can both empower the poor and

expand their livelihood opportunities; for example, education and skills. Finally, security will often be strengthened by improved access to markets. For example, access to insurance and other markets give the poor more options in managing risk. Access to wider or non-local food markets may provide options to stabilise supplies and prices.

Table 1: Links between markets and strategies against poverty

Strategy against poverty	Potential positive roles of markets	Examples of market factors that may work against the poor
Growth	Promoting efficiency in allocation and use of resources.	<ul style="list-style-type: none"> Market failures and distortions in factor markets (capital subsidies) that prevent efficient allocation of productive resources. Disabling economic framework.
Empowerment	May provide incentives for local organisation.	<ul style="list-style-type: none"> Poor lack livelihood assets (land, capital), and are disadvantaged by low education and poor health. Structure and functioning exclude poor. Poor not involved in setting market rules; lack of voice.
Equality of opportunity	Access to assets, services. Markets for assets of poor (notably labour).	<ul style="list-style-type: none"> Adverse or weak institutions that discriminate on the basis of transaction size or impose unnecessarily high technical standards. Social exclusion. Higher transaction costs in poor areas due to infrastructure. Weak demand for assets of poor people. Market failures (e.g. credit markets and excessive market power).
Security	Risk management. Supplies of food and other basic requirements.	<ul style="list-style-type: none"> High transactions costs. Incompleteness of markets.

(Source: DFID/OPM 2000, 3)

The framework recognises that even successful market development may not assure a pro-poor outcome. Markets can exclude the poor, especially those who are destitute and have little to offer the market. Social or economic barriers to entry may mean that specific groups of the poor – notably, ethnic minorities, migrants, women or members of certain castes – are excluded from markets. Conventional policies for market restructuring and reform – such as liberalisation and privatisation – cannot simply be assumed to be poverty-reducing through an anticipated ‘trickle-down’ process. On the contrary, it is now widely accepted that explicit methods must be considered in order to encourage and promote participation by the poor.

Moreover, an analysis of the functioning and development of markets, and their potential role for reducing or exacerbating poverty, cannot be undertaken in purely economic terms. Markets also exist in social space and are deeply embedded in a set of non-market, social and political institutions. The way in which people, and the poor in particular, participate in markets is conditioned by economic, political, social and cultural factors which must be incorporated in the analysis. In the original framework, such an analysis was presented in terms of four domains (see Table 2 below).

Table 2: An analysis of markets based on four domains

Market Domain	Key Issues
Enabling environment	<p>What roles are played by institutional and environmental factors, such as international markets, macroeconomic policy, financial and legal infrastructures and forms of governance?</p> <p>Issues:</p> <ul style="list-style-type: none"> • The importance of a stable macro-economic environment. • Low entry and exit barriers to business, and efficient and deepening factor markets, to maximise efficient allocation of resources and opportunities for the poor. • Regimes that produce greater equality of opportunity throughout the economy. • Secure and stable property rights, which guarantee an adequate control over the returns to assets, enhance market development and efficiency. • Social insurance mechanisms and investments in basic infrastructure, health and education, enhance the likelihood for the poor to benefit from market development.
<p>Market failures:</p> <ul style="list-style-type: none"> • public goods, externalities • market power and economies of scale • asymmetric information • costs of establishing and enforcing agreements 	<p>How do markets fail, and which alternative arrangements arise?</p> <ul style="list-style-type: none"> • Barriers to entry are too high as a result of government or private sector institutions. • High transaction costs and the risk of transaction losses are often associated with lack/inadequacy of infrastructure and information. • Collective action may be a cause of collusion and barriers to entry, or a response to market failure (reducing transaction and information costs). • Government policy may impose high risk and transaction costs. Can the state address critical market failures? • What level of infrastructure and public intervention encourages market development and which elements of these are particularly important for poverty reduction?
Adverse power relations	<p>What economic, social, cultural and political biases inhibit the poor from participating in, and benefiting from, markets?</p> <ul style="list-style-type: none"> • Markets exclude or discriminate against the poor because of the lack of economic assets, lack of political/institutional rights and/or lack of social connections. • Regulations and social norms may be biased against the poor, and supportive of bigger and more powerful organisations.
Inter-market linkages	<p>Is the performance of a market critically determined by the development of, and integration with, other markets?</p> <ul style="list-style-type: none"> • Access to financial/insurance markets increases access, and the terms of access, to assets in other basic markets and vice versa.

Source: derived from DFID/OPM 2000

The M4P framework also recognises that markets are also not the only institutions that provide economic exchange, co-ordination and allocative functions. Gifts and hierarchies are also used either alone or in combination with markets. The NIE literature explains the internal organisation of firms and of governments using hierarchies as alternatives to markets (or as complementary to markets where governments and firms, as part of their own governance arrangements, combine hierarchies with internal markets).

Circumstances where non-market solutions may be needed are where transactions costs are so high that markets fail or do not exist, or where large firms abuse their market power in situations where government capacity to regulate monopoly is limited.

The Evolving M4P Framework

Since the development of the original M4P framework document, a number of M4P branded' interventions have been developed and initiated. These developments have been 'organic' and country-led, as strong central guidance or direction on M4P issues was limited when these

interventions were being designed. Consequently the interventions that emerged are perhaps more diverse than was originally planned. The M4P framework has been used as a practical tool for developing specific market-enabling interventions and approaches to private sector development. Examples include market-enabling interventions in the cases of FinMark and ComMark in Southern Africa and PrOpCom in Nigeria (see text boxes), an investment climate survey in Bolivia, support for collective action by clusters of SMEs in Jamaica, and business service development with KATALYST in Bangladesh.

There have been theoretical developments of relevance to M4P. For example, Sen's

Development as Freedom argues that choices, and the capability to exercise those choices, are a good thing in their own right. The expansion of freedoms that are enjoyed by people is seen as both a means and an end for development. In this analysis, freedom of exchange and transaction is in itself part of the basic liberties that people have reason to value.

Conversely, the rejection of the freedom to participate in, for example, the labour market is a means to keep people in bondage and captivity. From a different perspective, *The Fortune at the Bottom of the Pyramid* (Prahalad 2004) examines the prospects for 'large-scale entrepreneurship' in order to empower the poor and serve the poor in exercising choice as consumers.

There has been much new work and discussion on the importance of institutions as determinants of long-term growth (Rodrick 2002, Rodrick et al 2004, Chang 2002, Ohno2004). Other work (Sachs 2003) questions an over-emphasis on institutions at the expense of other determinants such as geographical location. The 'Drivers of Change' approach to understanding policy processes (DFID 2002) indicates that a better understanding of political economy is key to understanding prospects for reform and market development, as well as specific options for donor engagement.

In agriculture, Dorward et al (2004) revisit the appropriate roles of the state, the private sector and civil society in situations where markets are perceived to be performing poorly especially in poor rural areas. Drawing on quantitative analysis of active state interventions in 20th century 'green revolutions', they suggest that current policies which emphasise the benefits of liberalisation and state withdrawal fail to address critical institutional constraints to market and economic development in poor rural areas. They conclude that a fundamental reassessment of policies espousing state withdrawal from markets in poor agrarian economies is needed. Given widespread state failure in many poor agrarian economies today, particularly in Africa, new thinking is urgently needed to find alternative ways of 'kick starting' markets – ways which reduce rent-seeking opportunities, promote rather than crowd-out private sector investment, and allow the state to withdraw as economic growth proceeds.

Joffe and Jones (2004) present another perspective on this issue in their examination of means to stimulate market development for pro-poor agricultural growth. They conclude that the orthodox public-private division of roles in relation to market failure, and the provision of public goods, is insufficient and that more innovative mixed public-private partnership arrangements are required. In many contexts there is a case for time-limited public actions, provided that the actions are well designed and take into account the capacity of the parties to bear risk. Specific models examined include: (a) private enterprises taking over public functions; (b) building market linkages for smallholders; (c) building market institutions; and (d) private investors in supply chains.

Finally in the area of business services there has been a significant shift towards ‘market development’ approaches. The main differences between a traditional and a market development approach are summarised in Table 3 below.

Table 3: Comparison of conventional with market development approaches

Conventional development approach	Market development approach
1. Understanding of the ‘system’	
<ul style="list-style-type: none"> • Businesses as beneficiaries of business support. • Provision by government organisations and NGOs. • Services typically defined as public goods and financed primarily by the state. 	<ul style="list-style-type: none"> • Businesses as discerning consumers of services. • Provision by private sector in functioning markets. • Private services. • Through provider-consumer transactions. • Market-supporting functions by a variety of actors.
2. What are business services	
<ul style="list-style-type: none"> • Narrow view: formal/education oriented. • Non-financial services deemed by agencies or governments to be ‘good’ for business, mainly training and counselling. 	<ul style="list-style-type: none"> • Broader view: enterprise/pragmatic oriented. • Any non-financial service to business, offered on a formal or informal basis.
3. How they should be provided	
<ul style="list-style-type: none"> • Organisations: Mainly government-owned or sponsored agencies and not-for-profit agencies. • Rigid, modular ‘one size fits all’ approach to delivery. 	<ul style="list-style-type: none"> • Market system: mainly the for-profit private sector, including informal networks, business associations and business-to-business relationships. • ‘Right-sized’ delivery demanding a diversity of service offers and service providers.
4. How they should be promoted	
<ul style="list-style-type: none"> • General support for design and delivery of business services, with an implicit assumption of continued subsidy and often standardised services. 	<ul style="list-style-type: none"> • Finite, focused support aimed at addressing business service market constraints through limited interventions; ‘facilitation’.

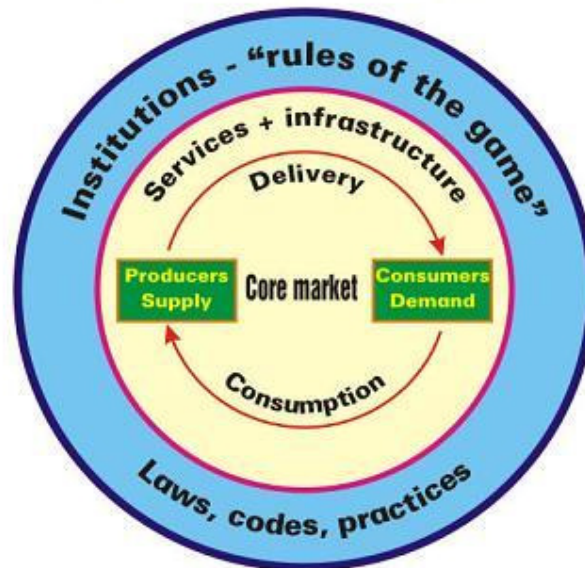
Source: DFID (2004c)

Extensions of the M4P framework

The need to operationalise M4P has led to some specific extensions of the M4P framework. Before a market can work for the poor, it must first be able to work at all. The following section looks at the main elements of a functioning market.

What does it mean for a market to ‘work’? The most documented attempts to interpret and apply the M4P framework have been under the ComMark and FinMark programmes in Southern Africa (Gibson et al 2004, Porteous 2004). A working market has four components, shown in the ‘layers of the onion’ of Figure 1 below (adapted from Gibson et al 2004, 12):

Figure 1: The components of a functioning market



In the centre is the 'core market'. The forces of demand and supply are the necessary and sometimes sufficient) conditions for markets. Demand is driven by Consumers who wish to buy products and services and have the means to do so. Consumers are likely to have differing levels of income and hence willingness to pay. In a well functioning market, all those who are able to afford to pay the minimum cost of producing an acceptable product are served by producers. In thin or distorted markets, only the needs of the better-off are met.

The demands of consumers are met by Producers who supply products and services to the market. If the dynamics of supply and demand promise sufficient returns, firms will attempt to overcome the problems of weak institutions and infrastructure themselves. Examples include extractive industries in many territories and some firms (e.g. South Africa Breweries) that have a core competence in working in difficult environments. The market structure in terms of number, size and type of participants (firms, households, etc) will vary greatly among market sectors based on their history, their stage of growth and the barriers to entry.

The core market is supported in the 'first layer' by infrastructure and services that provide the physical requirements of a market, as well as services to market players and regulators. Infrastructure and services – notably communications, transport, finance, bookkeeping, etc –may be provided by Government and/or private providers through fee-based or 'embedded' services. The provision of infrastructure and services are critical to a functioning market. For example, if the cost of transport is too high, markets will not develop; if there are no certification services, producers may not be able to export; or lack of bookkeeping and reliable auditing services may deter investors, etc.

Completing the overall context is the second layer, the institutional context, which is comprised of the rules and organisations, including informal norms that coordinate human behaviour (see Section 2.2.4 for more analysis of institutions). The institutional environment is not fixed. To function well, the institutional environment must be inclusive, and capable of picking up feedback and signals from diverse market players. It must balance interests by negotiating change and facilitating agreement. And it must be able to implement solutions.

Institutions can vary from trust and other forms of social capital at their most informal through to conventions and codes of private sector organisations through to the laws, rules, regulations, and regulatory enforcement capacity at the formal end of the spectrum.

Common problems with institutions relate to the power of concentrated interests (e.g. monopolists and monopsonists) who are able to shift the 'rules of the game' in their favour.

This may result in barriers to market entry, low levels of competition, high levels of rent-seeking, and the exclusion of newcomers. Non-economic exclusion may be practiced based on exclusion by gender, race, religion, ethnicity or social status (e.g. caste).

Markets are institutions which work by efficiently facilitating exchange. A well-functioning market reduces transactions costs and risks between buyers and sellers. In such a market, while each component will differ in form, there will be certainty and basic stability about how the components fit together. In newer markets, the roles of the different players are often still in the process of definition. An inherent characteristic of mature markets is their constant evolution in response to changing circumstances and the feedback effects from other markets.

What is a market that works for the poor?

A market which works for the poor is one which expands the choices available to poor people and produces market outcomes that benefit the poor. These outcomes include job opportunities with attractive wage rates, better returns on goods sold, and greater affordability of important products and services. Over time the participation of the poor in these key markets should increase. In terms of contributing to pro-poor growth, the key indicator will be the average rate of growth of the incomes of the poor. From the perspective of the poor, the important criteria are improvements in:

- access to important markets and overcoming any forms of market exclusion;
- affordability (for purchases);
- returns (for sales) including wages from the sale of labour;
- choice; and
- risk reduction.

It is also helpful to distinguish between markets in which the poor participate directly and those where the links are indirect. In the cases of direct participation, conditions such as the differential access of different groups of the poor can be quite precisely measured. But in other cases (e.g. international commodity markets) the poor are not direct participants, although the outcomes of these markets are critical for the welfare of the poor. In M4P, both types of market need to be analysed, and the policy implications for each type of market will be rather different. Some approaches, e.g. value chain analysis, attempt to map the linkages between a distant global market (indirect link) and the markets in which the poor directly participate, e.g. labour markets or markets for unprocessed agricultural products. A number of M4P interventions attempt to improve the distribution of value to the poor through institutional innovations (producer groups) and systematic attempts to add value to the products of poor producers through pre-processing, quality improvements, vertical integration with large processors, etc.

Market growth, market deepening and the access frontier

A key feature of a market that works for the poor is the rate of market expansion, so that the products and services being supplied by the market are brought within the reach of the poor. Porteous (2004) describes a stylised market development over time (shown in Annex 3) to show how this process occurs. The significant aspects of this are the lowering of prices and the increased availability of the product or service, driven by the profit-seeking behaviour of incumbent and entrant firms. Growth may itself generate virtuous cycles through economies of scale that will enable further cost reduction and/or profitability to be achieved. In the presence of competitive forces that allow new entry, a healthy market will show increasing usage, but at a decreasing rate as it approaches a natural limit.

Another important concept for M4P is the access frontier, which is defined as ‘the maximum design redistribution mechanisms that don’t ‘crowd out’ the private sector altogether. If private sector players are driven away, the access frontier effectively becomes a ceiling and the market will not be able to work for the poor. However, if state sponsored redistribution can meet the needs of the very poor while maintaining the incentive for private firms to participate – e.g. through market segmentation – then the access frontier can continue to push out, increasingly including the poor. proportion of usage possible under existing structural conditions of technology, infrastructure and regulation’. The position of the frontier, and the rate of movement towards it, reflect both a deepening of the market and the extent to which the market is working for the poor. A key policy choice relates to whether the state wishes to increase the use of the particular good or service beyond the access frontier into what is termed ‘the supra market zone’. There are various redistributive techniques that can do this, ranging from subsidies through to market segmentation and price discrimination. The challenge – from the M4P perspective – is to design redistribution mechanisms that don’t ‘crowd out’ the private sector altogether. If private sector players are driven away, the access frontier effectively becomes a ceiling and the market will not be able to work for the poor. However, if state sponsored redistribution can meet the needs of the very poor while maintaining the incentive for private firms to participate – e.g. through market segmentation – then the access frontier can continue to push out, increasingly including the poor.

Institutional and Political Economy Change Analysis

The institutional context – or the outer layer of the market ‘onion’ shown in Figure 1 – presents a key challenge for the M4P framework. Achieving institutional and systemic change in the operation of markets important to the poor is at the core of the M4P approach. The complex interaction between economic, political, institutional and social factors determines why certain contractual arrangements are in place, and how they affect market access and the livelihoods of the poor. The work of Harriss-White (1996) on power relations within agricultural markets in India provides an example of the application of political economy and anthropological perspectives to the analysis of markets. Institutional and political economy change analysis can also guide the selection, design and implementation of interventions which may be required to promote some competitive markets and prevent the failure of others. For example there may be cases where investment in roads or telecommunication may be necessary to reduce transaction costs in agricultural markets.

Regulatory frameworks that create a market or enhance competition may also be needed, for instance for financial intermediaries and information services. Collective action may also be required to generate effective demand, or diversify delivery of goods and services for the poor.

Drivers of Change

The objective of identifying and supporting systemic change that produce market outcomes that benefit the poor has profound implications for what action should be taken. Effective use of the framework implies a strategic and catalytic role amongst potential ‘constituencies for change’ who may be drawn from all three pillars of the state, private sector and civil society, supported, where appropriate, by donors.

Drivers of Change are a way of understanding the political economy of growth and poverty reduction (DFID 2002). Drivers of Change focuses on the longer-term underlying factors that affect the incentives and capacity for pro-poor change, as well as the prospects for reform. The approach starts from the local situation and examines the relative roles of change agents, institutions and structural issues. This type of approach is very relevant for M4P which aspires to achieve systemic change and recognises that it involves:

- Formal and informal institutional change. For example, reconfiguring the roles of the public sector, private sector and civil society in providing public goods and services; the promotion of accountability and transparency of government services and programmes; and supporting non-market institutions effective in providing services to the poor that reduce transaction costs and risks.
- Policy change. For example, improvements in regulatory rules that may facilitate the development of one or more markets and/or enhance the access of the poor to certain markets.
- Developing markets, market linkages and market infrastructure. For example, information, finance, business services, accreditation systems, credit bureaus, etc; promote or provide infrastructural investment, especially in rural areas, for roads and transport, irrigation and electricity, water and sanitation, and telecommunication.
- Addressing ‘pressure points’ or functions in the value chains that constrain pro-poor outcomes. For example, support for local empowerment and organisations for poor and marginalised groups, strengthening their participation in decision-making processes.
- Supporting market activity in the early stages of development where the onstraints and risks facing private agents are too great – though such activity must be very carefully designed and implemented to limit negative distortions, and to promote its phasing out in the transition to greater reliance on a stronger private sector.

Different interventions and a changing institutional mix may be needed at different stages of development. The table below sets out some changing Government and market roles.

Table 4: Stages of Development

Stage	Market status	Government roles in market development
Establishing the Basics	<ul style="list-style-type: none"> Thin or failing and stagnant markets. 	<ul style="list-style-type: none"> Stability and security. Reduced risk of expropriation. Basic infrastructure. Support to technology development / adaptation. Basic education and health.
Key reforms 'unleashing' growth	Unorthodox Hybrid Arrangements with Government roles in economic co-ordination and risk mitigation.	
	<ul style="list-style-type: none"> Growing and more reliable markets for seasonal finance, inputs and outputs. Increasing private investment. 	<ul style="list-style-type: none"> Market oriented incentives in place, e.g. decentralization of production decision making to households, time limited and performance-related investment grants/ protection.
Sustaining growth and competitive advantage	<ul style="list-style-type: none"> Global integration. Deepening private markets in operation. Increasing private investment. Increasing participation by bigger and more diverse enterprise types, e.g. services. Wider multipliers and growth linkages. 	<ul style="list-style-type: none"> Credible institutions and enforceable 'rules of the game'. Checks and balances to maintain transparency and predictability. Promotion of 'competitive coordination' (competition for efficiency and equity incentives but deliberative mechanism for industry coordination where necessary).

Putting M4P into Practice – a tool to promote pro-poor growth

We now turn to the practical application of M4P, or how M4P can be used as a framework for action. The M4P approach can be applied in two ways, as (a) an analytical tool to bring new insights to policy development and programme designs that will bring about systemic institutional and market system change in support of pro-poor growth; and as (b) a tool for intervention.

M4P as an analytical tool

The M4P approach can be applied at a number of different levels. At the macroeconomic level the approach can provide constructive inputs to national strategic planning, including the Five Year Plan system, and nationally-driven Growth and Poverty Reduction Strategies, as well as sector plans. The holistic and integrative nature of the approach means that it can be useful in co-coordinating or specifying the linkages between different sectoral ministries and departments (e.g. Finance, Trade, Agriculture and Infrastructure). For donors, the approach can help to formulate assistance plans and strategies as well as specific instruments such as the PRSC and other programmatic and policy-based instruments. In a decentralised environment the approach could also be applied to provincial Growth and Poverty Reduction Strategies. At the meso- and micro-level, the approach can be used to identify specific 'pressure points' for change within value chains.

The analytical work has three main dimensions:

- a) Poverty and livelihood strategy analysis. This includes a better understanding of the market systems within which the poor are embedded and an understanding of livelihood strategies.

b) Market analysis. An analysis of the extent to which outcomes in markets that affect the livelihoods of the poor are pro-poor.

c) Institutional and political economy change analysis.

Poverty and livelihood strategy analysis

The starting point is a better understanding of poverty and of the market systems that affect the lives of the poor. This includes current interactions between markets and the livelihoods of the poor, as well as analysis of future market opportunities and constraints. The poor interact directly with markets in three ways:

1. Producers and sellers of goods or services.
2. Consumers or buyers of food and other essential commodities.
3. Employees of businesses or other organisations where they are paid a wage in return for their labour inputs.

Depending on which markets the poor are interacting with, well-functioning markets that

are accessible, affordable and offer choices, adequate returns and simple low cost means of settling exchanges can improve the welfare of the poor by providing higher income and returns from their assets (e.g. labour – or the products they have sold). Similarly, lower prices for the goods they buy may also increase their real net incomes. But the intensified competition resulting from greater market integration may be a two-edged sword, bringing simultaneous positive and negative effects. For example, markets may bring greater production efficiency and lower consumer prices, but also a livelihood loss for existing producers.

Market interactions are dynamic. Structural changes in an economy present new opportunities. Poor people will try to improve their welfare by changing their livelihood strategies. There are different roles for markets in different livelihood strategies as well as requirements for new and different markets that must work in combination. Three such strategies can be identified (Dorward et al 2005).

- Maintenance or ‘hanging in’ - concerned with preserving current levels of welfare with the current portfolio of activities.
- ‘Stepping up’ – increasing productivity and incomes in the sectors in which the poor currently earn their livelihoods.
- ‘Stepping out’ - transition to new forms of livelihoods that provide higher incomes, notably self-employment or wage employment in manufacturing and services. This is the major pathway out of poverty for most poor rural people. Well-functioning labour markets will be critical for ‘stepping-out’, as will means to transmit money, access to education and a stable source of low priced food. When people ‘step out’ they will need to be able to sell or rent out assets that will be left behind such as land and property.

Market analysis

The core of the M4P approach will be a solid and comprehensive analysis of the market in order to identify areas of potential systemic change. The following questions are relevant:

- How are markets changing and how are they likely to change as a result of wider, external processes of change? What opportunities are there for support to wider processes of growth?
- How well do these markets currently serve the poor, in terms of ease of access, security of access and conditions of access?
- How do these markets fit into supply and value chains? How do these chains operate: where are the constraints, where are the high returns being made?
- What stakeholders are involved in these markets and what are their roles, their interests, and their strengths, weaknesses, opportunities and threats?
- What are the barriers to entry and the transaction costs and risks for different stakeholders?

Institutional and political economy change analysis

The M4P approach is based on changes in the market system in order to achieve pro-poor outcomes. This means changing the incentive structure (the risk to reward ratio) sufficiently so that private sector players will become increasingly involved in the delivery of pro-poor market outcomes. Incentive structures also have to be considered to motivate politicians, bureaucrats and other powerful stakeholders to support pro-poor change. Systemic change may be brought about by addressing:

- inappropriate institutions and policies, particularly those that act to exclude the poor;
- market structure and infrastructure,
- market failures, particularly those related to coordination failure;
- providing new or enhanced services; and
- stimulating pro-poor business linkages.

M4P as a tool for intervention

M4P can also be used as a practical tool for intervention. Constructing a case for a market development intervention depends on identifying exactly why the goods and services in question are being sub-optimally supplied. It is not always the case that a market failure is occurring, or that market failure can easily and economically be remedied.

Joffe and Jones (2004) discuss three areas of constraint in which private investment may be deterred by the lack of profitable opportunities due to the following:

a) Weak 'fundamentals' such as low demand, low prices, high production costs and distance from markets. The scope for market development is severely constrained and is likely to remain so without substantial public investment in infrastructure and technological change. The private sector may still be partners in this process through various forms of Public Private Partnership (PPP). However a substantial subsidy element will be required.

b) Extensive market and/or government failures. Mechanisms to reduce and manage risk come to the fore, such as insurance, guarantees and other financial instruments, but also via institutional strengthening, novel partnerships and contractual arrangements. The sustainability of any intervention may be compromised without parallel longer term reforms, structural change and public investments to improve the investment climate.

c) Poor access to finance, either debt or equity. Measures to strengthen the rural financial sector may be the priority, including institutional strengthening and new product design.

Degrees of Intervention in Markets

Another perspective is to consider interventions in terms of increasing likely degrees of market distortion:

- a) The most neutral interventions are those aimed broadly at the removal of existing distortions, and improvements to the investment climate.
- b) Next are non-transactional interventions that aim to improve or enhance supply of and demand for goods and services within a given market via education and training, improved information availability, and various institutional measures to reduce transaction costs.
- c) The least neutral are interventions that directly affect the prices of goods and services via some form of subsidy. Such measures if maintained indefinitely will distort consumption and investment decisions.

Concluding remarks

Even where there is a case for market intervention, the M4P intervention must be further filtered through a 'poverty reduction lens'. This is likely to be comprised of the following three criteria:

- a) Bang for buck Are there sufficient numbers of the poor in the market to make the intervention worthwhile?
- b) Accelerating pro-poor growth? Will the intervention make a significant contribution to Pro-poor Growth (PPG)? The choice of sectors should be informed by the concept of stepping-up or increasing productivity and incomes in the sectors from which the poor currently earn their livelihoods; and stepping-out or helping the poor access new sectors that have the potential to provide better livelihoods. The simple phrase 'stepping-up and stepping-out' captures much of what makes for a pro-poor pattern of growth.
- c) Systemic change. Within these sectors/areas, are there suitable sub-sectors/areas for bringing about systemic change?

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