Letters to the Editor

Dear Editor

Market development (M4P) is an approach to development that encompasses objectives, a framework for analysis and understanding and 'how to' guidance for action. As interest in M4P grows among development agencies, the 'normal' things are happening. There is variable progress in its application with signs of mainstreaming in some areas (for example, finance) and more patchy use elsewhere (for example, value chains); the first evidence of significant impact is emerging but there is a need for more detailed evaluation; there is a general mushrooming of abbreviations (M4P, MMW4P and so on); and, as people sense a trend and a catchy wholesome slogan (but choose to ignore substance), suddenly the market development brand is attached to anything remotely connected with the poor and markets (hardly a small category).

In this context, for M4P to progress further, there is a need to bring clarity – conceptual, strategic, operational – to it and debate over its potential usefulness is necessary and to be welcomed. However, for this to be meaningful, it needs to be grounded in a valid, common understanding of the key issues. Regrettably, Jorg Meyer-Stamer's paper (*Making Market Systems Work? For the Ppoor*, SED December 2006) doesn't provide such a basis for discussion. Before we (the field) can move on there is a need to refute some of the essential flaws and inaccuracies that abound within it.

Flaw 1: M4P 'does not share the view that an enabling environment is a sufficient condition for pro-poor growth'. The bigger point is that M4P asserts that an environment that is enabling comprises more than written regulations and rules but includes essential information, knowledge and services. Indeed this was accepted in the recent Donor Committee conference on the enabling environment (and noted in its communiqué). M4P is built on this systemic view of development and offers frameworks and guidance to give tangible meaning to this.

Flaw 2: M4P evolved from the BDS discussion in the late-1990s. No, BDS was but one of many strands of thinking and experience that have arrived at market development. A key strength of M4P is that it has

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arisen from similar but separate processes in different development boxes – finance, livelihoods, agriculture, BDS, property/land – where the same conclusions have been reached. The phrase 'making markets work for the poor' was coined in a World Bank paper in 1993 (on housing) and born again in 2000 in a major DFID paper. M4P's roots are not only from the relatively small world of small enterprise. It originates from a wider experience and speaks to a wider reality.

Flaw 3: M4P's conceptualization of markets is inadequate, especially its failure to address hierarchies and networks. No, M4P is based on a multi-function, multi-player view of market systems that recognizes the undeniable reality of market operations. This is not some abstract, idealized notion of spot markets drawn from the rarefied world of neo-classical economics. M4P builds on the immediate practicality of institutional economics: for markets to work effectively, for them to innovate and grow, a range of things need to happen. In particular, if they are to work for poor people where transaction costs are higher, the right rules, services, information, incentives and so on need to be there as an inherent part of the market system (not a temporary input from donors).

Market functions can be delivered through commercial transactions, yes, but often flow through informal exchange between different public and private players or within the same organization. And all of these processes and structures are within market system. Rather than stick with an artificial market-network-hierarchy distinction, M4P's view of a market system subsumes all of these and does so in a manner that is (a) conceptually rigorous (helping us to understand the world), and (b) has utility in guiding development work (helping us act to change it).

For example, FinMark's major success in South Africa (and beyond) – strangely unmentioned in the paper – has been based entirely on this so-called 'weak' conceptualization and on acting to developing various functions around the financial services market; regulatory processes, information services, the environment for innovation, all of which require engaging with different private and public players.

Flaw 4: M4P neglects the meso level. M4P gives specific, tangible meaning to what is meant by 'systems' that are conducive to individual and business growth. Micro-meso-macro may well be an interesting general means of conceptualizing the world but when it comes to acting to change it, is of limited utility – with endless fretting over what is meant by each term. For example, the 'microeconomic business environment' of Michael Porter seems close to the meso level of other writers. What does micro and meso mean here? M4P replaces this confused picture with a functions and players view of market systems that builds around the central questions: why isn't the market system working? What are the underlying reasons preventing this happening? What actions can be taken to address these 'systemic constraints'?

Flaw 5: M4P's view of the poor is somewhat blurred. The starting point for M4P should always be an understanding of how market systems impinge upon the poor. To be clear, M4P's moral imperative is the same as that of the wider development world. But how 'the poor' are defined precisely is a matter for intervening agencies and governments. The M4P approach doesn't seek to impose its own definition. There are enough of them out there already – 'working', 'ultra', 'poorest of', 'poor-ish', 'middling' (I exaggerate) – without adding another. Blurred? More like not seeking to be pointlessly precise. The key point is to understand how the poor – however defined – participate (or could participate) in market systems, how they can do so more effectively and to measure this change.

Flaw 6: M4P assumes that growth will automatically benefit the poor. M4P is closely allied with agencies' pro-poor growth agenda. Hence, while growth is recognized as the biggest driver of poverty reduction there is no blanket textbook assumption that growth will deliver benefits to all equally. The extent to which the poor benefit is influenced by a number of factors: whether the poor participate in markets as consumers, workers/employees and/or producers/enterprise-owners; their geographical position and the opportunities available to them. In some cases, the benefits to the poor from market growth will be tangible and immediate; in others less so. The point of intervention is to identify systemic constraints that prevent them getting the most from markets and to address these.

Flaw 7: M4P is silent on the role of government. No. Clearly many of the functions required to make markets work effectively are roles that often government (and sometimes only government) can undertake. And government's weakness in playing these roles is often a critical reason for overall market weakness. An endemic problem in agriculture, for example, is that government, instead of focusing on those functions that only it can perform – such as basic research, information and disease control – and doing these well seeks to do too many things (especially ineffectual extension) resulting in crowding out of the private sector and inept public sector sprawl. This is recognized explicitly in M4P. Whether or not interventions engage with government of course will depend on other factors – most important their capacity to influence government successfully when underlying constraints and resistance to change are deep.

Finally, what is missing from the paper is any recognition of the substantial impacts already being achieved in M4P interventions. This is not some obscure, theoretical construct. M4P – now – is showing itself to be a successful way of developing markets systems effectively and inclusively. In contexts and sectors as different as South Africa (financial services), Uganda (information and voice) and Bangladesh (vegetable farmers) literally millions of people are benefiting from M4P interventions.

Of course, the paper – even if ill-informed and partial – does highlight some genuine issues in taking M4P forward. Public documentation and literature around M4P is currently weak (although Jorg might have looked a bit harder!). There is a need to better explain the basics – the why, what, how (and why different) – of M4P. This is not a proprietary methodology with an individual legal custodian – potentially a great strength since a distinctive quality of M4P is its applicability in many development spheres. Developing the clarity, rigour and exposure that are required in order for its promise to be realized is therefore a collective responsibility – and a central challenge for the way ahead.

Yours
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Dear Editor

I must admit that I am somewhat puzzled as to how to respond to Alan's letter. He does not substantiate any of his statements, for instance by giving references. Yet he is, obviously, not the only thinker in the M4P arena, just as the M4P thinking has not yet evolved into a consolidated and consistent framework. In fact, I would tend to suggest that there are at least three schools of thought. They differ, among other things, in the way they deal with the three theoretically possible modes of coordination, that is, market, hierarchy and network. Practically oriented people are not always comfortable with this concept. They like to point out that the three types usually appear in some kind of combination. Indeed, there is also no doubt that the functionality of each of the three usually depends on the other two. For instance, a market only works when hierarchy is present (in the shape of government that creates an enabling environment, for instance by securing property rights and by curbing private monopoly, and in the shape of companies that internalize processes with high transaction costs) and when networks exist (for instance business networks, which are another device to minimize transaction costs). Nevertheless, in any given economic setting, transactions tend to be quite obviously predominantly organized either in markets, or in hierarchies, or in networks. Job placement is a typical example. Some countries have a sector of for-profit private job placement agencies, namely, a market solution. In other countries, job placement is a government monopoly, namely, a hierarchy solution. Yet other countries have neither, and job placement is achieved through informal communication among business people or within social groups, namely, a network solution.

There are no other ideal types, that is, no other ways of organizing economic transactions. Any economic transaction is predominantly done in a market, in a hierarchy or in a network. Distinguishing the three is not about some academics playing with beads. It is rather a matter that involves important alternatives and choices – which are often not explicitly reflected by development practitioners.

How does the discussion on M4P relate to the concept of market, hierarchy and network? The conceptual discussion and practical work on M4P has evolved along three distinct trajectories. *The market focus*. This perspective is linked to the Commark project in Southern Africa (Ferrand et al., 2004; Centre for Development and Enterprise, 2006). It is aligned with what Altenburg and Drachenfels (2005) have called 'the new minimalist approach to private sector development', where government is supposed to limit itself to creating an enabling environment so that markets can work effectively and efficiently. This perspective has no documented sound conceptualization of microeconomics and market failure, and no documented systematic understanding of interventions necessary to remedy market failure. Markets are expected to work provided that the framework conditions are right, and they are supposed to be by far the most efficient mode of organizing economic activities. The Commark documents are quite explicit about the fact that functioning markets are perfectly sufficient for a thriving economy, and that hierarchy, as in selective government interventions, is creating more damage than benefit. Networks do not figure in these documents.

The markets and hierarchies focus. This perspective is linked to the work of authors like Dorward and Kydd (2005) and others (for example, Kydd et al., 2004). It is based on insights from agricultural economics. It highlights the fact that it is not necessarily a good idea to rely on markets only, since what appears as a perfect market in theory can be a transaction cost nightmare in practice. Markets with lots of small suppliers and customers are a reality in rural Africa, yet they don't work very well since it is time consuming and thus costly for customers to get a comprehensive picture of the variety and quality of produce that is on offer; 'market exchange in Africa is generally "costly, cumbersome, time-consuming, and unpredictable"' (Dorward and Kydd, 2005). Hierarchies, for instance outgrower systems that are managed by a major company, can turn out to be significantly more wealth creating than markets under such circumstances.

The markets, hierarchies and network focus. This perspective has emerged from the work of the ADB/DFID project in Vietnam, which has over time broadened its focus (see the papers available at http://www.markets4poor.org/). Regarding hierarchy, it looked at issues such as 'Strategies for State-Led Social Transformation', namely, the role of government as a driver of development, and it also looked at contract farming, that is, hierarchy in the private sector. Regarding network, it addressed issues such as collective action.

Each of the three schools of thought has it upside and its downside.

Market focus. The upside is the sharp focus. One downside that necessarily comes with this focus is the appearance of a one-sided market fundamentalist approach. Another downside of the existing literature is the unsystematic way in which it deals with market failure and possible ways to address market failure.

Market and hierarchy focus. The upside is the more balanced perspective, since this perspective acknowledges the inherent limits of markets. The downside is the neglect of network as the third important mode of organization.

Market, hierarchy and network focus. The upside is the coverage of all three modes of organization, namely, a holistic perspective that does not a priori judge that one mode is better than the others. The downside is that this focus reflects an evolutionary process from 'Making Market Systems Work for the Poor' to 'Making Everything Work for the Poor' which, from a practical perspective, is a steep task.

Moreover, it is important not to ignore an important dilemma in this respect. Limiting the perspective to markets alone compromises the 'for the poor' ambition, especially if one takes a closer look at the causes of poverty. Poor people are often excluded, which takes us to a finding that appears tautological: markets don't work for excluded groups because they are excluded. Markets are embedded in networks and other societal structures, and poor people often don't benefit from markets because they are marginalized by or entirely excluded from those structures. Exclusion is a process that is embedded in and reinforced by social structures. Thus, it is important to acknowledge that 'making markets work for the poor' is not a simple, straightforward task where limited interventions in certain markets will do the trick. It rather involves quite fundamental interventions into societal structures – another steep task. Distorted markets are often the outcome of power disequilibria. In this case, 'making markets work' is not an abstract task but rather a very concrete attack on very powerful people. In some places, like in traditionally structured regions in Latin America or in some post-communist countries, some people who tried this died very unpleasant deaths.

Given these challenges, it is important to remind oneself that a 'making markets work' approach has persuasive advantages. One of the most important ones is the intrinsic quality of coordination through markets. Markets work because participants pursue their self-interest. Hierarchies are facing all sorts of problems, such as the principal-agent problem where the power centre is constantly battling with the challenge of making sure that the agents who receive orders or missions fulfil them in the way the principal wants them to. Networks are also facing all sorts of problems, such as the problem of numbers, where a network that involves a significant number of players creates a huge coordination effort and cost. Markets are coordinated in a decentralized way. They don't require a coordination centre. Markets tend to emerge quite spontaneously – even in places where the framework conditions are decidedly business unfriendly. Therefore, during the design phase of development interventions it is crucial always to ask: can we achieve whatever we want to achieve through a market-based solution? If we can, then once we have made the market work we can turn around and do something else quite different from hierarchy- or network-based solutions that tend to need endless nourishing and care.

Moreover, the M4P approach can go beyond the 'minimalist approach'. The minimalist approach tries to create favourable framework conditions and then expects markets to do their miracle in a spontaneous way. The M4P approach acknowledges that markets often won't do that, and that in particular they will not benefit or even exclude the poor. Thus, targeted interventions are necessary to make sure that markets work, and to make sure that they work for the poor. The M4P approach has so far generated a significant body of research studies that analysed markets and the way they worked, or didn't work, for the poor.

In my view, the most adequate conclusion is to conceptualize M4P as a set of tools rather than an overarching approach. Framing M4P as an approach to fundamentally change the world creates all sorts of issues. I would rather want to relate back to the starting point of the M4P approach, namely the intention to better understand markets, market failure and practical ways to make markets work better. Practitioners in various fields, not only in private sector development, would be well served with straightforward analytic tools and change tools. In this respect, the M4P literature that exists so far is only partially helpful. What is yet to emerge is a toolkit that can guide practitioners in their efforts to make markets work. Some of the existing M4P documents are interesting for development practitioners, while others are hardly penetrable. None of them are the kind of handbooks that practitioners can easily use. The best service the M4P community of practice could deliver to the wider development community would be to come up with practically useful guidance in terms of how to analyse markets and market failure, and how to address dysfunctional markets in a very practical way.

Regards

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