# The role of public policy in inclusive agrifood markets

## Conference Issues Paper 3

**Market restructuring and modernization in emerging economies presents major challenges for public policy. There is a vitally important role for the public sector to enable successful alliances between smallholders, SMEs and larger business, especially if initiatives are to be scaled up. Can public policy make a difference to 'making markets work for the poor'? This Issues Paper looks the evidence of how public policy and donor policy can work for successful inclusion of the poor in dynamic markets, even within an overall framework of liberalized markets.**

### Key messages

- **The role of the public sector and donors is changing towards a focus on the facilitation of business partnerships between small-scale farmers and other actors in the supply chain. This requires a whole new set of policy skills and instruments.**
- **There are many economically rational and socially valuable market interventions that governments can carry out to facilitate sustainable business partnerships between smallholder farmers and other actors in the supply chain.**
- **Policy concern has focused too much on export markets and on changes in the 'downstream' retail sector.**
- **The most successful innovation brought forward by the Regoverning Market case studies is the emergence of specialized market intermediaries which are both business-oriented and development-motivated. There is much that public policy can do to foster the development role of this sector. Policies are needed to address improvements in midstream markets and upstream procurement. The benefits of upgrading can spill over into traditional markets.**
- **Public policy has a well-known role in overcoming the 'hidden costs of inclusion'. Infrastructure investments may be critical to get excluded producers and wholly excluded regions into the market.**
- **Policy makers need to consider the value of traditional markets, not just the allure of the modern sector.**
- **Public agencies can do far more to link actors in a way that facilitates information exchange and creates foundations for successful chain-wide learning.**

### What are the policy challenges to linking small-scale producers and SMEs to modern markets?

Agrifood markets are in an unprecedented state of flux, and are generating intense policy debate worldwide. Market liberalization, a reduced role of state and a shift towards market-driven policy, changes in consumer preferences and purchasing power, and the modernization of food processing and retailing are primary drivers (see Issues Paper 1).

If the Millennium Development Goals (MDGs) are to even partially be met by 2015, then market modernization and restructuring has to deliver a growth and equity 'win-win'.

Governments have significant room for introducing pro-poor policies, even within an overall framework of liberalized markets. This room is underutilized. Even the most avid proponents of enterprise-based solutions to poverty and environment acknowledge a vitally important role for the public sector to enable successful alliances between smallholders, small-medium sized enterprises (SMEs) and larger business, especially if successful small initiatives are to be scaled up. Public policies favouring inclusion can at the same time be pro-poor and pro-market; there is no contradiction.

For-profit business can do much to improve the development impacts of their business models (see Issues Paper 2). But the risks of government inaction, and of delegating market governance to private actors, can lead to islands of well-serviced producer groups in the most favoured regions, amongst a sea of producers servicing low-value markets.

### Policy drivers and constraints to restructuring

As noted in the Issues Issues Paper 1, government policy already has a significant impact on either insulating producers from or exposing them to the opportunities and risks of modern dynamic markets.

For example, wholesale market regulation policies in Turkey and India have forced buyers, including supermarkets, to procure via wholesale markets rather than directly from producers and their organizations. India's Agricultural Produce Marketing Committee (APMC) Act has now been amended in 14 Indian states, making direct market connections between farmers and agribusiness.

**Case study: Wholesale market law in Turkey**

In 1995, a wholesale market law was instituted that mandated that retailers (and other intermediaries) must buy produce from the wholesale markets, from licensed wholesalers (operating on commissions). The exceptions were those buying very small quantities, those buying from farmer coops, processing companies or exporters. While in theory this gave impetus to the formation of cooperatives, the latter remained very limited.

*Continued overleaf*

The law essentially acted as an almost total constraint on supermarkets buying direct from production areas except when they could procure from coops. But there are extremely few co-ops - this may be a mutually reinforcing cycle. The law was partially amended in 2007, now stipulating that 10 per cent of the market stands have to be reserved for co-ops. However, supermarkets still have to buy via the wholesale markets (paying a fee), even if they arrange the transaction directly with the farmers. Under these conditions the established wholesale sector fills the gap. Licensed wholesalers in the big cities are backward integrating by investing in packing plants in rural areas, horizontally integrating by setting up stands in production-area wholesale markets, specializing with dedicated relationships with supermarkets, and setting up networks of agents to extend credit and collect produce from farmers.

Another brake on restructuring and market penetration is a dominance of production by small farms, such as in China and Indonesia. In China, production is extremely small scale (on average 0.6 ha). While the Land Law allows and encourages land transfer and consolidation through the land rental market, land consolidation has progressed only slowly because farmers have use-rights of land for only 30 years, rather than ownership.

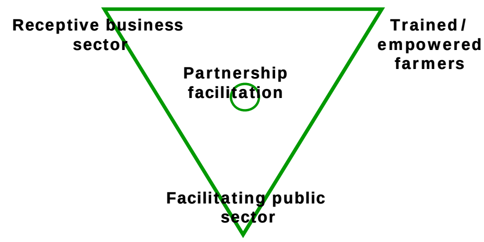
There are also various forms of restriction on foreign retail, through zoning regulations under the jurisdiction of local authorities (as in Thailand and Indonesia), or local rules blocking foreign hypermarket development, as found in provinces of Poland.

On the other hand, some governments and local authorities have had a major role in stimulating the development of the supermarket sector. In China, local governments became entrepreneurs and major stakeholders in local retail enterprises, before the liberalization of the retail foreign direct investment (FDI) sector as part of accession to the WTO.

Restructuring is also impacted by the manner in which food safety legislation is introduced. If regulations become too strict they can act as a barrier, keeping small farmers out of the market.

## Innovation in policy for inclusive markets

To achieve and sustain inclusion of small farmers in restructured markets, different agents need to participate and cooperate. This is the big challenge. The successful examples identified in case study research share the characteristics of collaborative arrangements between (a) trained and organized farmers, (b) a receptive business sector, and (c) conducive public policies and programmes. Such arrangements are in most cases supported by (d) specialized partnership facilitators. The actors in these successful initiatives got all the elements right. There is no gain in getting one element right if you fail elsewhere. This calls for comprehensive strategies and for specialized and skilled players, including the public sector. Such strategies and the engagement of skilled players are expensive and require time to mature.




What is meant by 'conducive public policies and programmes'? This of course includes the 'enabling environment' of infrastructure and support services, but can extend further, to policy innovations that promote the development of inclusive markets and create incentives for pro-poor procurement.

## Enabling environment

A priority and well understood area of public policy intervention is that of the enabling environment.

**Impacts of road and market infrastructure on farmer's participation in modern channels in eight countries**

| Country: product | Road and market infrastructure |
|---|---|
| India: dairy | + |
| Zambia: beef | 0 |
| Poland: dairy | + |
| China: Cucumber | + |
| China: Tomato | + |
| Indonesia: Potato | + |
| S. Africa: Tomato | 0 |
| Turkey: Tomato | 0 |
| Mexico: Strawberry | 0 |

'0' no impact (or impact is not statistically significant)
'-' statistically significant negative impact
'+' statistically significant positive impact
For China, because there is almost no modern channel, parameters presented in this table are for farmers selling to wholesalers (compared to brokers).

### Infrastructure

In the case of smallholder and SME participation in supply chains, the enabling environment refers to the consistent provision of key infrastructure services (roads, water, electricity and communications). Rural transportation and market infrastructure are essential for small farmers to effectively participate in markets. Empirical research shows that generally better road and marketing infrastructure facilitates farmers' participating in modern market channels, though the impacts in some country studies are not statistically significant (see Table). Attention to infrastructure is central to preventing territorial exclusion that restructuring can exacerbate.

Among eight countries studied, four found that the distance to roads or markets or dairy collection points has significant negative impacts on farmers selling products to modern channels. When farmers live further from roads or markets, they tend to sell to traditional market buyers.

Another pillar of the enabling environment is the provision of and access to relevant support services to help facilitate business partnerships between smallholder farmers and other actors in the supply chain, and the existence of complementary targeted public investments such as agricultural research. Most documented cases of successful market intermediation make little mention of the public sector, and many are fully private-sector-driven and completely independent of any support from government or NGOs. This points to a critical capacity gap in the public sector.

**Land policy and non-land assets**

Research has shown a very strong link between restructuring and patterns of land ownership. When there is a dualistic structure, as in South Africa and Zambia, then it will always be an uphill task for small-scale producers to compete in formal markets. But rather than farm size or land being the determinant of exclusion, it is far more usual for non-land assets to be that determinant. Evidence from research shows that the policies that foster non-land assets - such as irrigation, greenhouses, cooling tanks, and so on - may help to improve access. This is good news for policy makers because this is an 'actionable' result for government programmes.

**Finance**

Many smallholders are credit constrained. Financial services are crucial for farmers to access dynamic markets and sustain their participation. There is a 'missing middle' for producer organizations and rural SMEs that lack access to financial services. As supermarkets and processors tend to pay only after a lengthy period, there needs to be a mechanism to bring liquidity into the supply chain. In addition to working capital, other financial services like investment capital, alternative collaterals, and risk management can have a strong impact on the success of smallholder inclusion. Public sector procurement systems can take even longer to pay than many supermarket chains. In Bolivia, this constraint is solved either by groups that benefit from NGO support (or by groups already having a high commercial turn over). Again, most documented cases of successful supply chains for small-scale producers' financing do not involve the public sector.

**Competitive marketplace**

Over-reliance on self-regulation and voluntary pro-poor initiatives by business misses the point of market governance. Genuinely effective business models work best in a strongly supportive policy environment – supportive for both producers who want to connect to those chains, but also for those who cannot. Relevant public policies to maintain a competitive marketplace and to provide oversight of the working of contract laws, contract enforcement and legal redress, are a central element of an enabling environment. Codes of practice, either voluntary (see Argentina case study in Issues Paper 2) or statutory, can provide protection to suppliers when they trade with powerful buyers such as supermarkets. Codes may be backed by a supplier ombudsman with an independent regulatory role, as in place or planned in Australia and the UK.

**Management of FDI**

The risks and opportunities of attracting supermarket retail FDI from a development perspective are both compelling and uncertain, and it is legitimate for countries to seek to retain some policy space to manage these investments. Retail investments are not necessarily a win-win-win for producers, consumers, and broader economic growth. There is a potential large trade-off between attracting FDI in retail services and the livelihoods of primary producers and the informal retail sector, where a high percentage of the population is dependent on agriculture and informal trading. Governments and investment promotion agencies (IPAs) need to maximize the benefits and minimize risks of attracting retail FDI. IPAs could offer help with investment impact assessment and advise foreign investors how to align their policies with national development goals.

### Support for pro-poor procurement

Public policy can encourage business to preferentially procure from small- and family-scale producers and SMEs, as attempted (with varying degrees of success) in Brazil with the biofuels social seal, in Colombia with the Green Markets Strategy, in South Africa with AgriBEE, and in Punjab through the PFAC.

**Case study: The biofuels Social Seal in Brazil**

The National Programme of Biodiesel Production and Utilization (PNPB) involves two key players: large biodiesel production firms, and rural unions representing family farmers and rural workers. The Social Seal from the Ministry of Agrarian Development is a promising tool to improve the equity of the "biofuels revolution" by providing the downstream biodiesel industry with incentives to source their feedstock from smallholders and family farmers. Biodiesel produced in the very poor north east region of Brazil needs to contain at least 50 per cent of raw materials produced by family farms. The amounts in other regions range from 10 to 30. per cent. To support the programme, the private firms provide technical assistance to the family farmers.

**Case study: Colombia Green Markets Strategy**

The Colombian Ministry of the Environment developed the Green Markets National Strategic Plan as a way to respond to the country's obligations under a number of international treaties, such as the Biological Diversity Convention and the Andean Regional Biodiversity Agreement. Under the Plan, the Ministry signed an agreement with the supermarket company Carrefour to promote the marketing of "green products" derived from indigenous plants from the Amazonian tropical rainforests. The Ministry also provides technical and financial support to producer organizations, and assists them in developing business plans to respond to the new "green market" opportunities. However, this policy failed to stimulate effective consumer demand for the green products based on the Amazonian indigenous chillies. In addition, the production, harvesting, processing and post-harvest management of several of the undomesticated species also proved to be difficult undertakings.

**Case study: South Africa AgriBEE**

In South Africa, the political pressure on large-scale farmers and agribusiness to get involved in empowerment initiatives is increasing. The AgriBEE (Agricultural Black Empowerment) scorecard gives credence to preferential procurement, but so far there has been little impact in terms of facilitating small emerging farmers entering modern formal segments of the food system. Employers may alternatively be encouraged to pursue the partnership model exemplified by Thandi, where shared equity and worker co-ownership can have a demonstrative impact on the industry.

**Case study: 'Tripartite model of linking farmers and agribusiness in Punjab, India**

The state agency Punjab Agro Foodgrains Corporation (PFAC) has been the main instrument of a Government of Punjab policy to mitigate the environmental impacts of the predominant wheat-rice production system in the region through diversification of farm production. The initiative began with the reform of the APMC, allowing farmers in the state to sell their produce in places other than the designated government markets. In addition, the state government agreed to reduce taxes and levies charged to produce sold to agribusinesses engaged in contract farming schemes. The PFAC actively intervenes in linking farmers and agribusinesses, providing a range of services and actually acting as an intermediary during the initial years ('tripartite model'), until the relationship is developed to the point where farmers and agribusinesses are ready to deal with each other directly ('bipartite model'). The scheme has expanded the area under contract farming in the Punjab from 120,000 to over 1 million hectares in only six years.

**Support to producer organizations**

Case study research has shown the high importance of organizational assets – empowering farmers through effective and innovative farm associations and cooperatives – and policies that support group marketing and collective bargaining.

Policy support for collective marketing can be done at national level, such as in Canada and Australia. In Australia**,** competition policy has been amended to give special status to collective bargaining in agricultural markets. Agricultural cooperatives have been given greater room for collective bargaining, avoiding cumbersome legal procedures for obtaining permits. The amendment is based on the acknowledgement that in agriculture transaction costs are higher due to scattered production among many producers. The replicability of these systems in developing countries needs to be better understood.

The experience of law in Poland to encourage formation of producer groups is useful. In the eyes of most producers in Poland, cooperatives are ideologically tainted. The law allowed a choice of legal form, which can be adjusted to the level of invested capital and safeguards needed.

**Support to intermediaries**

New forms of support services are emerging in response to the restructuring of agrifood markets. In this new environment the role of public policy, or at least of donors and support agents, is changing towards a strong focus on the facilitation of business partnerships between smallholder farmers and other actors in the supply chain. This requires a whole new set of skills and instruments.

Rather than focus on changes in modern retail and their policy implications, policy attention needs to be reoriented towards midstream improvement and downstream production and procurement.

The most successful innovation uncovered by the case study research is the emergence of specialized market intermediaries that are both business-oriented and development-motivated. These are 'doubly-specialized intermediaries' because they are specialized and dedicated not only to satisfying the requirements of downstream firms such as supermarkets, but also to ensuring inclusion and development of small-scale farmers. The existence of these specialized intermediaries often makes the difference between successful and sustainable small-scale farmer inclusion, and failure. They need support from donors and government agents, especially to meet the challenges of food safety legislation and traceability. But policies can be a hindrance, imposing restrictions on small-scale, often informal traders and middlemen who are of particular importance to the poorest farmers. This is demonstrated by the case study of Tongzhou in China.

**Case study: Restriction on agricultural brokers in Tongzhou, China**

The Tongzhou area traditionally produced cash crops such as vegetables, melons and beans. Although the quality of those products was high, farmers faced difficulties getting a good price in local markets. Consequently they explored other marketing channels and gradually became agricultural brokers. Because of abuses from some brokers, the governments had banned them for several decades, thereby preventing smallholders from connecting to urban wholesale markets. In the late 1990s, the government realized the vital role brokers play in value chains and small farmers' inclusion and changed strategy to organize them into associations. This allowed a solution to the farmers' marketing problem.

**Private-public partnerships**

When a market is dominated by small traders, there is a great challenge in meeting consumer's demand for food quality and safety. There are novel models of private-public partnership to coordinate production, quality and marketing such as avocadoes and phytosanitary standards in Michoacán, Mexico.

**Case study: Local Phytosanitary Boards in Mexico**

Within the framework of structural adjustment the Mexican government decided to downsize the state phyto-zoosanitary agency, transferring some of its functions by law to farmer organizations. This created a political opportunity for farmers to control trade flows in agricultural products, as they were now issuing the phytosanitary permits. At the same time, a free trade agreement was being negotiated with the USA and Canada, creating economic opportunities for increased exports. The farmers organized in local and state-level *Juntas de Sanidad Vegetal* to create the capacity to take advantage of the new institutional and economic context. This private-public partnership and dual change in incentives and capacities in Michoacán, allowed avocado farmers to coordinate the production and marketing, built around phytosanitary standards thathas generated enormous growth and prosperity for avocado farmers.

**Bringing chain actors together**

A very under-explored role of public agencies is to link actors in a way that facilitates discussion and information exchange. Examples include chain-wide committees facilitated by the Secretary of Agriculture and Ranching in Honduras. This exchange helps in policy design. Recent work by the World Bank shows that many value chain participants feel unable to access existing 'enabling' policies due to their poor design.

In the UK, a Procurement and Development Forum has been convened by the Department for international Development which brings leading food sector companies together to discuss how to innovate in support of inclusive and pro-poor procurement.

**Supporting vibrant traditional markets**

Some emerging modern markets are extremely small, niche and donor-influenced, and can be a distraction from the priorities of broad-based rural development. And even very progressive modern procurement systems can be exclusionary. Public resources may in some instances be better invested in upgrading traditional markets, thanks to the high volume and less demanding standards.

In South Africa, two empirical studies both reached the same conclusion that more than 80 per cent of the small-scale farmers sell their fresh produce to hawkers and less than 20 per cent supply to formal agribusiness such as agro-processors or supermarkets. Farmers prefer informal markets to formal agribusiness (supermarkets and agriprocessors) because the latter have stringent demands in terms of quality, quantity and delivery, their price is lower than that in the informal and spot markets and it is fixed (resulting in low and fixed prices).

So there is a clear role for policy to encourage traditional markets to innovate and compete. Policy has to deal with and help upgrade, rather than punish, the informal sector, as acknowledged by the Kenya Dairy Policy.

**Case: Kenya Dairy Policy**

The new Dairy Policy being discussed in the Kenyan Parliament has signalled a clear departure from the old and ineffective 'command and control' approach to regulation of informal and traditional milk markets. The Kenyan Dairy Board used to police the informal markets to try to stamp out the informal small-scale milk vendors (SSMV). After decades of harassment, these vendors still command 85 per cent of the market. Even before the new policy's legislative approval, a new approach is underway.

Licences are issued to SSMVs, linked to compliance with quality and hygiene regulations, and business development services, including training and certification, are now available. Through ASARECA, the pioneering Kenyan approach is being promoted in Uganda, Tanzania and Rwanda. Also, there is an Eastern African regional effort to rationalize and harmonize dairy policies and standards across borders, including adoption of common training and certification materials and approaches. A key trigger of the change in approaches was a research and development project (Smallholder Dairy Project) jointly implemented by Kenyan (KARI) and international (ILRI) organizations, in close coordination with a range of dairy industry stakeholders.

## A call to action

- Successful inclusion of the poor in dynamic markets requires many well-known but still highly important roles for public policy.
- These roles include meeting 'hidden costs of inclusion', especially infrastructure investments that may be critical to get excluded producers up to speed, and which can prevent whole regions from being excluded. Attention must also be paid to preserving a competitive marketplace.
- But inclusion also requires new and innovative roles for public policy, to:
  - Put structures and incentives in place for business to do the right thing, i.e. to build inclusive pro-poor procurement systems
  - Work with and upgrade **chain intermediaries** to build on their strengths and connection to small-scale producers, while improving their development impact
  - **Bring chain actors together** into learning alliances.

Regoverning Markets is a multi-partner collaborative research programme analyzing the growing concentration in the processing and retail sectors of national and regional agrifood systems and its impacts on rural livelihoods and communities in middle- and low-income countries. The aim of the programme is to provide strategic advice and guidance to the public sector, agrifood chain actors, civil society organizations and development agencies on approaches that can anticipate and manage the impacts of the dynamic changes in local and regional markets. The programme is funded by the UK Department for International Development (DFID), the International Development Research Centre (IDRC), the Canadian International Development Agency (CIDA), ICCO, Cordaid, and the US Agency for International Development (USAID). The Beijing conference was further supported by DFID, IDRC, CIDA, and the Dutch Ministry of Foreign Affairs/Development Cooperation (DGIS). The views expressed are not necessarily those of the funding agencies. For further information see www.regoverningmarkets.org or contact RegoverningMarkets@iied.org