

DFID
Making Market Systems Work Better for the Poor (M4P)
Summary of the introduction to the concept

The evolving M4P framework is described including the origins of M4P as well as more recent attempts to apply the M4P framework in specific countries. M4P remains work in progress. The aims of the introductory paper are to provide better understanding of the M4P concept and to stimulate discussion of refinements and improvements that will make M4P a more effective tool for promoting pro-poor growth.

The MDG Context. 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.

Market and State Failure. 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-cases, the supply of the good or service becomes a form of patronage. In the 1980s, the widespread problems of “state failure” – poorly conceived state interventions in markets – provided the basis for the “Washington consensus” - a return to an economic policy framework based on the operation of free markets.

Making Market Systems Work Better for the Poor (M4P) evolved as an approach to support pro-poor growth that learns from the well-known problems of both state and market failure. M4P aims to accelerate pro-poor growth by improving market outcomes that matter to the poor in their roles as entrepreneurs, employees or consumers. M4P focuses on changing the structure and characteristics of markets to increase participation by the poor on terms that benefit them. It addresses the behaviour of the private sector and therefore reinforces the strengths of market systems, rather than undermining them.

The intellectual origins of M4P can be traced to New Institutional Economics and other 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. A framework paper entitled “making markets work better for the poor” was produced by DFID/OPM in 2000. This “original” framework presented four domains for the analysis of markets covering (a) the enabling environment, (b) market failure (c) adverse power relations and (d) inter-market linkages. The work inspired a number of M4P branded interventions in South Africa, Nigeria, Bangladesh, Laos, Cambodia and Vietnam amongst others. In addition, new theoretical developments in range of relevant areas including: the role of institutions, political economy analysis (“Drivers of Change”), Development theory (“Development as Freedom”) the provision of business services via market systems (“Blue Book”; CGAP, ILO “Primer) and Value Chains have also enriched the evolving M4P framework.

M4P as a framework for understanding. Before a market can work for the poor – it must first be able to work at all. Early attempts to operationalise the M4P concept examine more systematically the components of a functioning market. These are identified as (a) the “core market” comprising producers and consumers (b) various outer layers of services and infrastructure and (c) institutions. A market which *works for the poor* 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. In terms of contributing to pro-poor growth, the main success indicator is the average rate of growth of the incomes of the poor.

A key feature of a market that works for the poor is the rate of market expansion coupled with the growing participation of the poor in the market. The **access frontier**, which is defined as ‘the maximum proportion of usage possible under existing structural conditions of technology, infrastructure and regulation’ is a useful analytical tool. 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. Key policy issues relate 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’ and also the means by which the state intervenes - which may have various distorting and budgetary implications.

Institutional and systemic change in the operation of markets important to the poor is the main area of focus for M4P. 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. **Drivers of Change** is a way of understanding the political economy of growth and poverty reduction that 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.

M4P as a framework for action. The M4P approach can be applied as *an analytical tool* to bring new insights to policy development and programme designs and as *a tool for intervention*.

M4P as an analytical tool has three main dimensions,:

- a) **Poverty and livelihood strategy analysis.** including a better understanding of the market systems within which the poor are embedded and an understanding of livelihood strategies. The main livelihoods strategies of the poor are defined as:
 - **Maintenance or ‘hanging in’** - 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.
- b) **Market analysis** -. the functioning of markets that are important to the poor both directly and indirectly; the extent to which market outcomes are pro-poor and potential intervention areas.

c) Institutional and political economy change analysis

M4P as a practical tool for intervention. Following the analysis described above, there may be a case for one or more market development interventions. These interventions should be screened via the M4P 'poverty reduction lens' i.e. considering the number of poor people that will benefit from the intervention, as well as the likely contribution to pro-poor growth in relation to the size of the intervention. In addition it must be clear 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. Three areas of constraint in which private investment may be deterred and possible interventions are identified:

- a) **Weak 'fundamentals'** such as low demand, low prices, high production costs and distance from markets. The scope for market development is severely constrained without substantial public investment in infrastructure and technological change or various forms of Public Private Partnership (PPP).
- b) **Extensive market and/or government failures** requiring mechanisms to reduce and manage risk such as insurance, guarantees and other financial instruments, but also via institutional strengthening, novel partnerships and contractual arrangements.
- c) **Poor access to debt and equity finance**, requiring measures to strengthen the rural financial sector, including institutional strengthening and new product design.

Degrees of market distortion must also be considered as interventions may be:

- a) **Neutral** - removal of existing distortions, improvements to the investment climate.
- b) **Intermediate**. non-transactional interventions that improve supply of and demand for goods and services via education and training, improved information availability, and institutional measures to reduce transaction costs.
- c) **Potentially distorting**. 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.

Further evolution and refinement. A number of areas of work are needed to further improve the usefulness of the concept. These may include, amongst others:

- Refining and mainstreaming M4P more fully within the development dialogue.
- Further integration of 'Drivers of Change' and other political economy approaches into the core of the M4P approach.
- Identifying the relevant institutions needed for effective markets.
- Markets, and their relationships with other forms of economic exchange including hierarchies, value-chains and vertical integration
- Gaining real participation by the private sector. The success of the M4P approach is predicated on the uptake of market functions by the private sector on a larger scale than is possible through support from donors and government.
- Better, more professional knowledge management, communications and advocacy capacity to support the dissemination of M4P.