Empowering Smallholder Farmers in Markets: National and International Policy Contexts

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Smallholder farmers often face constraints when they want to access markets or when they want to improve their competitiveness in markets. Market access and competitiveness relate to the options farmers have to sell their products and purchase inputs

Smallholder farmers often have low market access. Compared to their larger and more capitalized colleagues, smallholders are disadvantaged due to, small size of operations, weak technical capacity, high vulnerability to natural and market risks, and lack of capital. These constraints could be worse when smallholders are in remote areas. In addition, smallholders have difficulties in complying with the high quality standards that international markets and domestic supermarkets require.

National and international policy initiatives that aim to remove the constraints that smallholders encounter in improving market access and competitiveness could be categorized according to their main goal:

- Removing barriers to entry into markets
- Reducing market risk
- Reducing transaction costs
- Strengthening bargaining power
- Supporting producer organisations

Removing barriers to entry into markets

Barriers to entry into markets can be related to physical limitations in reaching the market, such as low quality of roads, to restrictions on international trade, or to minimum product characteristics required. These barriers mean that a certain market does exist, but that smallholders are hindered in selling their products on that market.

In recent years, much attention has been given to stricter quality and safety requirements for agricultural products. In many developed countries, public policies on safety and quality standards have been revised. Standards have been tightened on foods with safety concerns, while new standards have been developed for previously unknown or unregulated hazards or to address the food quality concerns of consumers. At the same time, product liability has come to play a more prominent role.

Quality and safety standards are often higher in developed country markets than in developing countries. With the rise in the relative number of urban consumers as well as in the number of supermarkets, barriers to entry are increasing also in domestic markets in developing country and transition economy markets. Global and local modern retail favour centralized procurement and preferred supplier systems, and often apply private quality standards. These purchasing practices entail higher market access constraints for smallholder producers.

World trade has expanded rapidly over the past decades. The current Doha round of WTO negotiations intends to reduce import tariffs and export subsidies for agricultural products. However, the impact of tariff reduction and market liberalisation on the agricultural sector continues to be heavily debated. While for exporting countries tariff reduction lead to improved market access, for farmers supplying local markets the picture may be less positive, as they will be faced with increased competition.

As the role of traditional trade barriers is reduced under (WTO, EPA) negotiations, the focus of trade policy discussions has shifted to non-tariff barriers to trade (NTTBs), which are becoming increasingly important in international trade issues. These NTTBs affect production in developing countries by raising standards and making it more difficult to trade. However, in some cases NTTBs create an opportunity for smallholders by protecting local products with specific labels or geographical denomination.

In several countries, public policies are targeted at strengthening local and regional markets. Where local and regional markets exist, farmers have more market outlets available (which improves their bargaining position), can economize on information costs (as it is easier to collect information on local consumer demand), and can more easily comply with special (local) consumer demands.

Reducing market risk

Agricultural producers face both market risks and risks that arise from natural conditions such as weather, pests and diseases. Farmers in developing countries generally face higher risk than their counterparts in industrialized countries. Smallholders, because of their low resource endowment, tend to be highly vulnerable to production risks, as well as to marketing risks that may result from price fluctuation or opportunistic buying behaviour.

In many developing countries risk behaviour and market participation are interlinked. On one hand uncertainty is reduced by participating in these market institutions provided this is based on improved market information, market outlets and communication. On the other hand uncertainty is exacerbated by greater market participation, since the safety net of subsistence is replaced by insecurity of unstable markets and adverse price trends.

In most developing countries, institutions (e.g. insurance) that can mitigate risks are missing or weakly developed. In the past, governments often reduced market risks by market intervention such as price stabilisation programs. With the withdrawal of state intervention, market risks for smallholders have increased, due to growing price instability, higher quality demands, more competition, and a lack of information on the side of the producer.

In the industrialized countries, farmers benefit from an array of arrangements to isolate or cushion farmers from natural and market shocks. Apart from provisions related to the welfare state, agricultural policies protect farmers from market risks. In addition, farmers in industrialized countries have been quite successful in pooling risks under cooperative insurance schemes.

Prior to the 1990s, state marketing boards were used by many developing countries. These boards took care of exports and producers received a minimum price regardless of world market prices, thus shifting market risk from farmers to national governments. However, as these turned out to be very costly for the state, many were dismantled. Nevertheless, such institutional arrangements continue to exist in several countries, such as in West Africa in the cotton sector and in Costa Rica in the coffee sector.

In Canada, farmers support single desk selling of certain products. They benefit from economies of scale when marketing their product. The benefits of the single desk exporter are passed back to the farmers who sold that product. State legislative measures have been adopted to enable farmers to use and govern this policy tool.

With the phasing out of price support schemes, many governments in the industrialized countries are now giving more attention to direct income support programs, which are supposed not to distort trade. But the lack of financial resources at the state level impedes the implementation of such measures in developing countries. Developing countries and transition economies are also interested in donor

driven schemes for risk management in agriculture, such as the EU-ACP Flex programme. However, there is a need for further studies to assess the real interest of insurance schemes in developing countries for smallholder farmers.

Acknowledgement of the fact that smallholders face different market risks compared to large, highly capitalized farmers may lead to the institutionalization of special protection programmes for smallholders. In Brazil, a distinction is being made between agricultural policies for a small group of export-oriented farmers and rural development policies for the large group of smallholder farmers, with a separate Ministry of Agriculture for each group of producers.

Reducing transaction costs

Market exchange, whether it is a spot market or a contractual arrangement, involves transaction costs. These costs can be summarized by the words contact, contract, and control. They include the cost of gathering and processing information on products, markets and agents, the cost of negotiation over a contract, and the cost of monitoring and enforcing that contract.

For smallholders it is often difficult and costly to obtain appropriate market information as well as reliable information on potential exchange partners. Once a market/buyer has been found, the producer needs to negotiate a contract and bargain over the price and other delivery conditions. The producer is often in an unfavourable bargaining position as the buyer has more information about market conditions, better negotiation skills and often better assets (financial, logistics, etc.). After having entered into an agreement, the producer has to make sure that the buyer keeps to its commitments, by monitoring buyer actions and by calling upon formal or informal enforcement mechanisms when the buyer does not comply. All of these activities entail costs i.e. transaction costs.

Even when buyers do not take advantage of their favourable bargaining position, producers still face coordination costs. These are the cost of information exchange and joint decision making to align producer decisions with buyer demands. These coordination costs increase when products become more customer-specific and quality becomes more important.

Public policies that reduce transaction costs consist of institutions that support market exchange, provide training for farmers and their representatives in contract design and contract management, foster institutions for dispute resolution, and support the establishment and strengthening of producer organisations. In addition, policies that support the provision of market information and improve the market "infrastructures" and services (transport, storage, financial services) also reduce the transaction costs that smallholders face in markets.

Strengthening bargaining power

Smallholders are often confronted with market structures that are more concentrated than the farming industry itself. Large buyer firms and large supplier firms have more bargaining power, have more resources available for market research and innovation, and have more options for adjusting to changing economic and regulatory conditions.

Bargaining power refers to the relative capacity to obtain favourable terms from a transaction. It is strongly related to access to information, to alternative trading options, to dependencies, and to the perishability of the product. The low bargaining power of smallholders may lead them to under-value their products and obtain a smaller share of the added value created in the supply chain. Smallholders have particularly low bargaining power when they supply products that need further processing, as economies of scale lead to high concentration among processors.

The bargaining power of smallholders may even decrease as customers are demanding larger volumes of uniform quality. As supermarkets demand products of the same quality in each of their stores, wholesalers may prefer procurement from large farmers that can supply homogeneous quantities.

Also on the inputs side, smallholders have low bargaining power compared to their suppliers. Seed companies, energy suppliers, equipment sellers, feed producers and other inputs suppliers operate on a scale that is far beyond that of the smallholder, giving them substantial bargaining power. Solution for this problem can be public provision of supplies and services or collective action by the producers themselves.

Supporting producer organisations

Producer collective action is often regulated by public policies, which can be enabling or constraining. Policies regulating POs can consist of both general laws such as company laws, commercial codes, and taxation laws, or special laws on marketing agricultural products (e.g. legislation on marketing board) or special legislation on the formation and operation of POs (such a laws on agricultural cooperatives).

Legislation on cooperatives is changing all around the world, in order to provide these organisations with more flexibility to respond to changing market conditions, to reflect the new balance between public and private responsibilities, particularly in former socialist countries and to provide a more enabling policy context for private market initiatives.

Even where legislation and regulation on POs exist, formalization of producer groups may not always be desirable. Informal organizations have more flexibility, particularly in countries where legislation on POs (such as cooperative law) is restrictive. In addition, registration of a PO may not be cost-effective. Moreover, formalization provides state authorities with the opportunity to tax the PO and/or its members. In situations where informal traders and middlemen do not pay taxes, establishing a formal marketing PO may not be an economically sound practice.

Arguments in favour of formalization are (a) the ability of the PO to enter into contracts and to borrow money; (b) the existence of a prescribed set of rules on the governance of the organisation, which provides clarity for both internal and external stakeholders; (c) the ability to enter into national and international collaboration; and (d) the existence of clear rules on the liability of the PO, its members and its directors. The advantages of formalization may become more important when the PO wants to enter, on behalf of its members, into contracts for the delivery of products with special quality characteristics.

Besides strengthening bargaining power, a PO can reduce barriers to entry, for instance by providing its members with advice on how to comply with quality standards; can reduce market risks for individual smallholders by establishing risk sharing mechanisms; and can lower transaction costs by gathering, processing and disseminating information on markets, products and transaction partners. Increasingly, policy makers acknowledge the important role POs can play in furthering smallholder market access.

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