

# From market-based development to value chain transformation: What markets can (not) do for rural poverty alleviation?

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## ARTICLE INFO

### Keywords:

Smallholders  
Poverty reduction  
Certification  
Market reform  
Inclusion  
Value chain transformation

## ABSTRACT

Market reforms are considered as an important strategy to support poverty reduction amongst small-scale agrifood producers in developing and emerging economies. Most attention is commonly focused on voluntary initiatives that provide a guaranteed minimum price to farmers and improve services for rural communities, supplemented by good agricultural practices for higher productivity, environmental quality and to support living incomes. Whereas alternative trade movements have become 'mainstream' their market shares are stagnating. Since agrifood markets have changed substantially and trade networks are restructured, smallholders are increasingly controlled by midstream agents (traders and processors) and captured into contract farming arrangements. This article outlines a new discourse around value chain transformation that supports local processing for income and employment generation and favours better integrated supply chains based on circularity and trust. It identifies new alliances between producers and traders that change market governance beyond simple adjustments in exchange relationships. Combining public investments (market infrastructure) with civic-driven organization (cooperation and contracts) and private networks (for profit redistribution along the value chain) offers interesting opportunities for linking sustainable business practices with value-driven trade arrangements.

## 1. Introduction

Poverty reduction is usually considered as a strategy that requires both public support and private sector involvement. Whereas state agencies are responsible for guaranteeing social safety and minimum living conditions for housing, health care, sanitation and education, small- and medium scale enterprises and large companies play a key role in the creation of productive employment, decent working conditions and a living income.

During the last few decades, we notice fundamental debates about the growing reliance on market-based initiatives, both from an effectiveness point of view and with respect to their implications for social justice. While some studies consider market reforms desirable and cost-effective (de Melo et al., 2020; Baumüller et al., 2013), others are more critical about the exclusionary principles of markets and their limited potential to include disadvantaged people (Cooney and Shanks, 2010).

Many voluntary organizations are involved in pro-poor value chains interventions and 'Making Markets Work for the Poor' (MMW4P) programs that try to improve market access for poor people and reduce transaction costs and risks at input and output markets (Thorpe et al.,

2020). Since their early start, commodity certification has become an important vehicle for linking smallholder farmers on more equal terms to international commodity markets. However, consumer's willingness to pay for fair and sustainable products proved to be overestimated. Due to growing disenchantment on the real poverty reduction effects, agrifood companies are now encouraged to focus more on living income benchmarks. In addition, discussions in the civic domain make a plea to support novel approaches towards 'true pricing' and 'fair chain' that value social and ecological externalities and modify value added distribution.

In this article we argue that – even while these market-based initiatives can contribute to the strengthening of farmer- and community organization - their socio-economic effects remain rather limited and do not lead to a fundamental transformation of the market dynamics. While this is partly due to problems of scale, there are several key design features that need reconsideration. Voluntary action clearly reaches its limits and further progress for the inclusion of poor farmers and for strengthening their bargaining position in markets can only be reached through much bolder actions that also change the structure and performance of markets (Guarín et al., 2022).

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<https://doi.org/10.1016/j.jrurstud.2024.103328>

Received 30 September 2023; Received in revised form 28 April 2024; Accepted 15 June 2024

Available online 25 June 2024

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It is important to recognize that several of the underlying mechanisms of market-based development face structural constraints that cannot be overcome through voluntary action. The organization of tropical commodity markets limits opportunities for equal competition and restricts efforts for just pricing. In addition to market-based reforms, more fundamental changes in the system of market organisation and better surveillance on the rules for conducting market transactions are required. The contours of such a new discourse become gradually visible and rely heavily on collective action for material and relational change in value chain interactions.<sup>1</sup>

This article therefore aims to identify the underlying motives for market-based development programs and tries to disentangle the different discourses that underpin their implementation. We use a conceptual framework that is based on a common understanding of the barriers that markets address and then discuss how different types of incentives could be helpful for overcoming these constraints. In practice, voluntary initiatives for market reform deliver limited impact on socioeconomic outcomes and practical experiences are rather mixed. Since agrifood markets also experienced major changes, there are good reasons to take a closer look at the opportunities for improving the structure of market organization. We argue that the emerging discourse of inclusive value chain transformation can be helpful to support the required structural innovations towards smallholder market integration.

The remainder of this article is organised as follows. Section 2 presents the conceptual framework for analysing different discourses on the role of markets for rural development. Section 3 provides a short overview on the insights on market-based policies from development discourses during the last few decades. Section 4 outlines major changes in market organization that many developing countries are currently experiencing. Section 5 discusses the difficulties of the voluntary initiatives for improving market engagement of poor smallholders. This paves the way for a more fundamental discussion on the needs and prospects for value chain transformation in Section 6. Section 7 concludes with recommendations for policy and research.

## 2. Conceptual framework

There are several standard approaches available for the analysis of the effectiveness of markets and institutions for poverty alleviation. Cooney and Shanks (2010) review four typical antipoverty strategies (microenterprise programs, microfinance loans, social enterprise support and bottom-of-the-pyramid schemes) and conclude that empirical research on their effectiveness is notably scarce. In an effort to identify different strategic pathways, Sutter et al. (2019) distinguish three perspectives on how entrepreneurship can alleviate poverty: remediation (reducing resource constraints), reforms (institutional change towards social inclusion) and revolution (systems change). In a similar vein, Caruana and Fitchett (2015) divide orientations in marketing discourses between technological, relational and power-oriented.

Shidharan et al. (2017) notice a gradual trend in market-oriented research away from a deficit-reduction approach concerned with overcoming resource constraints towards a more opportunity-expansion approach focussing on developing capabilities and well-being. Haggard and Kaufman (2012) argue therefore that governments need to ensure the involvement of the poor not only in the implementation market reforms but already during the policy-making process.

In our analysis of the underlying discourses on the role of commodity markets in rural development and poverty alleviation, we make a distinction between different the structural components of markets that

determine the opportunities and constraints for smallholder participation (such as high entry costs, limited competition and growing complexity of products) and the different strategies for reducing and mitigating these constraints, either through market-based incentives (prices, support services, etc.) or with institutional innovations in market governance (procurement arrangements, contracts, etc.).

We developed an analytical framework that distinguishes between three dimensions of market exchange (see Fig. 1). These are related to: (i) pricing mechanisms (volatile market prices, guaranteed minimum prices or profit sharing arrangements), (ii) payment procedures (spot transactions, premium payments or circular exchange), and (iii) investment priorities (yield gap reduction, adoption of better agricultural practices or further local processing). These three dimensions together capture the dynamics of interaction processes between smallholder producers and other value chain actors (such as traders, input providers and processors).

This framework enables us to identify three different discourses regarding the role of markets in rural development. The first discourse gives major attention to structural barriers that are occasioning current market failures and result in high price volatility, spot market exchange with limited bargaining opportunities, and consequently stagnant agricultural productivity and low rural incomes. The second discourse looks at market-based incentives for voluntary reforms that offer premium payments for community investments and farmer training towards improved agricultural practices, resulting in mixed experiences and limited effectiveness of efforts that intend to guarantee minimum prices and living income. The third discourse emphasizes the need for institutional innovations in value chain governance, giving priority to processing and value added creation in origin countries, local sourcing and circular chains, and profit sharing arrangements through cash transfers and direct payments.

The arrows refer to shifting discourse perspectives motivated by changes in the policy context and modified views on the strategies for enhancing smallholder inclusion that open perspectives for identifying novel instruments for rural poverty alleviation (Misturelli and Hefernan, 2008). These discourse shifts are triggered by a new conceptualization of the potential and limitations of market exchange procedures, combined with empirical evidence regarding the effectiveness of specific market reform practices (Verkuyt and Vermeulen, 1996). We selected relevant evidence for identifying these discourse shift from some highly-cited conceptual papers, further supported by robust empirical field studies and published systematic reviews.

Some major discourse shifts can be noticed in Fig. 1. Most pragmatic discourses on rural poverty alleviation search for margins within traditional relational exchange networks through technical-operational solutions for overcoming structural barriers to agricultural development, focussing on better seeds or yield-enhancing inputs. Market-driven discourses rely on strategies for modifying transaction mechanisms through price guarantees or premium payments combined with improved extension networks to promote the adoption of good agricultural practices (GAP). Institutional innovation approaches to rural development give more priority to better contractual arrangements for defining the distribution of value added and strategies for guaranteeing an equal level playing field for value chain bargaining relationships.

## 3. Market barriers for rural poverty reduction

Since decent exchange procedures have become part of the universally acknowledged package of human rights, poverty alleviation is generally considered as a global responsibility. Most international development cooperation programs were originally embedded in government institutions that especially focussed on public works (roads, electricity) and service provision (i.e. education, health care, drinking water and sanitation). Gradually also non-governmental agencies took part in these coordinated efforts for eliminating poverty and exclusion.

Governments in developing countries were accustomed to rely on

<sup>1</sup> Discourse shifts refer to fundamental changes in basic concepts, assumptions, beliefs and practices used for thinking about, looking at or doing something (Caruana and Fitchett, 2015). Shifts in discourse are usually related to changes in paradigms that encompass the set of theories and concepts used to conceptualize a specific discourse.

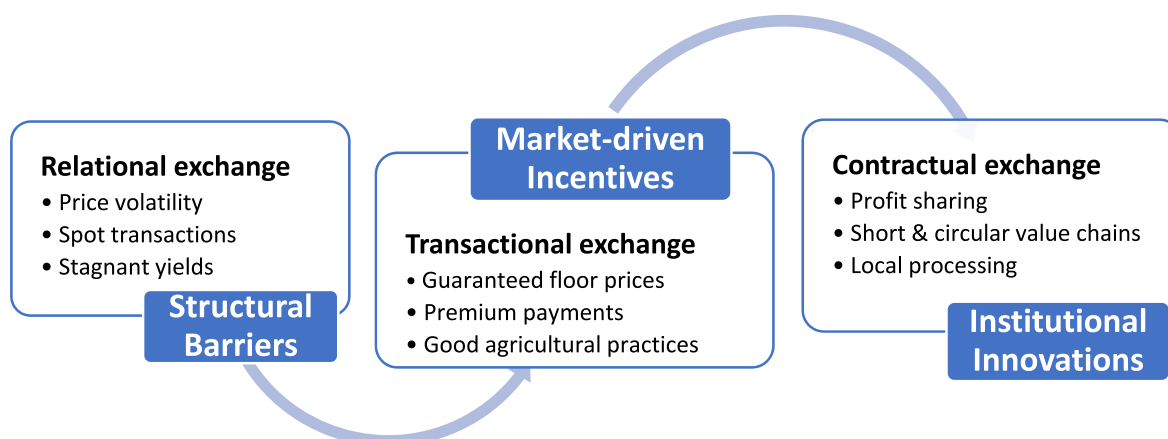


Fig. 1. Roles of markets in rural development.

market-based policies since the colonial period, when marketing boards controlled the trade in tropical commodities (such as cocoa, coffee, tea and cotton) and were used to collect taxes on exports (Abbott, 1987). Marketing boards were developed initially in countries of the British Commonwealth in the 1920s and 1930s and became widespread in many other countries into the 1960s. After decolonization, many of these bodies were maintained as (semi-)autonomous institutions. They became particularly important in providing marketing services to dispersed smallholder producers and contributed to certain stabilization in farm-gate prices.

The legacy of this long period of state-regulated markets is still visible in the way that commodity trade is organized and tropical value chains are governed. Post-colonial trade networks are heavily guided by vertical exchange principles and domination practices that have major implications for farmer's livelihoods. Smallholders are heavily dependent on relational exchange networks that determine their access to input and output markets.<sup>2</sup> Spot market transactions are guided by trust and reputation and many transactions based on reciprocity. The discourse focussed on relational exchange strongly relies on market-based exchange relationships and leaves limited scope for external interventions (Cooney and Shanks, 2010).

In such a relational exchange system, structural barriers that represent major causes of rural poverty can be registered in three particular areas (De Brauw and Bulte, 2021):

- High *price volatility* and limited market transparency, making investments for improving agrifood production very risky and encouraging farmers to engage in cost-sharing and sharecropping arrangements<sup>3</sup>;
- *Spot market* transactions that are based on instant delivery and pre-harvest pricing agreements, reinforced by informal kinship networks to reduce information barriers and delivery arrangements based on personal relationships;
- *Stagnant productivity* of agricultural activities with low average yields and high post-harvest losses, ultimately making farming less

attractive and thus encouraging smallholders to engage into non-farm activities and off-farm wage employment.<sup>4</sup>

Most public trade bodies were abolished since the late 1980s as part of structural adjustment programs of the IMF and the World Bank that promoted privatization, deregulation of markets, liberalizing foreign investment, and balancing government deficit (Lensink, 1996). Development cooperation focussed on reducing state expenditures and enhancing the functioning of 'free' markets in an effort to support economic growth, control fiscal balances and temper inflation. When detrimental effects of these programs on schooling, health and nutrition of vulnerable populations (particularly women and children) became overwhelmingly clear (Crisp and Kelly, 1999), criticism against this neoliberal approach to development finally led to its abandonment.

This opened important opportunities for developing some bottom-up initiatives to improve smallholder inclusion into (inter)national markets and to enhance the sustainability of tropical value chains. Most scholarly discussions centred around strategies for strengthening the bargaining position of smallholders in value chain focussing on higher output prices and better input provision, whereas other initiatives try to improve the functioning of value chains through reliance on longer term contracts and on payments for social and environmental externalities.<sup>5</sup>

Non-governmental organizations started to promote voluntary initiatives for making international trade relationships more balanced, using voluntary labelling (of fair trade or ecological origin) as key instruments (Ruben, 2017). These programs promise smallholders a minimum sales price and sometimes also premium payments to support community services. Other initiatives rely on the certification of specific best farming practices (i.e. soil and water conservation, organic production) or focus on guarantees for paying living incomes to farmers and living wages to workers involved in tropical supply chains (Waarts et al., 2021).

Several initiatives originating from the private sector also became important for linking trade to poverty alleviation. Individual businesses started to commit themselves to 'Corporate Social Responsibility' (CSR) as a form of self-regulation that reflects their commitment to contributing to the well-being of communities and society through several environmental and social measures. Carroll (2021) argues that CSR should go beyond good intentions and focus more on reaching real social

<sup>2</sup> Most relational exchange takes place within informal trade networks composed of a large number of unregistered traders that are engaged in multiple small transactions of goods and services.

<sup>3</sup> Sharecropping arrangements permit tenants to use land in exchange of payments with part of the harvest; the landowner may also furnish capital, inputs and cash to the tenant and could be partially paid with labour services.

<sup>4</sup> Many smallholders are also engaged in off-farm employment and non-farm activities that generate complementary income streams and contribute to risk diversification. It is therefore important identify yield-improving technologies and practices that do not require substantial more use of (family) labour.

<sup>5</sup> Note that better sales prices are easily outweighed by higher input costs charged by local providers since it is frequently the same person who delivers the inputs and buys the produce.

impact. In a similar vein, [Matten and Moon \(2020\)](#) make a plea for adoption of more explicit CSR practices and policies and the full integration of CSR in general business responsibilities. The OECD therefore provides international guidelines for responsible business practices related to workers' human rights, environment, transparency, and consumers interests. Recently, companies rely on the Environment, Social and Governance (ESG) framework to assess their business practices and performance on sustainability and ethical issues. This also marks the shift from philanthropy to mainstreaming of poverty reduction in regular business operations.

During the last two decades, international debates on the role of trade for development are shifting back towards a greater role for the private sector in poverty reduction programs, also paying attention to local employment creation, value added generation and environmental protection ([IEG, 2012](#)). Consequently, public funding for 'aid to trade' activities and value chain development programs showed considerable growth.

In summary, it appears that the market-based discourse leaves the initiative for pro-poor policies mainly to private parties, eventually supported by public investments to enhance market development through investment in public goods (infrastructure, information), thus strengthening the functioning of market to attract foreign direct investments (FDI). This discourse is gradually shifting towards greater direct engagement into local private sector development (PSD) through trade facilitation with credit and technical assistance programs ([McKenzie, 2010](#)). Growing pressure by civic organizations also encouraged private enterprises to respect voluntary standards and to implement due diligence of sustainable business practices.

In recent years, a new discourse is emerging that focusses on value chain transformation through coordinated action by public, private and civic agents (see section 5). This includes public regulation of the boundary conditions for inclusive and sustainable trade (i.e. minimum wages and product standards) combined with private sector commitments to contractual delivery relationships and just payment regimes, where civic organizations (both cooperatives and NGOs) at both sides of the supply chain try to balance the power relationships and support bargaining processes on production conditions, prices and payment regimes ([van Dam, 2015](#)).

#### 4. Recent changes in agrifood markets

International markets of tropical commodities were shaped during the colonial period when the market power was concentrated amongst a few large international companies that controlled the linkages between local intermediary traders and western retail networks ([Frankema et al., 2018](#)). Important elements of these asymmetric trade networks were the early commitments over upcoming harvests by local buyers and international companies engaged in future trade through global commodity exchange. Prices paid to farmers are thus 'decoupled' from actual exchange transactions and became strongly dependent on speculative trade arrangements.

Whereas the organization of international marketing and trade networks largely remains intact and leads to short-term price instability and deteriorating terms of trade, the governance structure of agrifood systems in origin countries and the organization of value chain networks around local value chains did experience quite important changes. The traditional system of bilateral smallholder-trader relationships based on spot-market transactions is gradually being replaced by procurement relationships with tight linkages where the role of local intermediaries that are in charge of post-harvest management becomes increasingly important. This is particularly caused by the growing product differentiation in tropical commodity markets, where consistent quality and opportunities for labelling and branding determine to a large extent the perspectives for value added creation.

The first fundamental change at the level of production systems is the gradual shift in operational farm size is taking place in large parts of sub-

Sahara Africa ([Jayne et al., 2016](#)) and to a much minor extent in Latin America ([Berdegue and Fuentealba, 2014](#)). [Jayne et al. \(2019\)](#) shows that medium-scale farms of 5–20 ha account for quarter to half of the agricultural area in major sub-Saharan countries, whereas their contribution to crop production and market supply is even higher. Land fragmentation continues at the bottom-end – mainly due to subdivision after inheritance – but a considerable growth in midsize commercial farms takes place that are owned by urban elites and managed by specialized operators (sometimes called 'telephone farmers', see: [van Dijk et al., 2023](#)). This 'bifurcation' is further reinforced by contract farming or outgrowing arrangements for perishable exports products such as flowers, green beans and mangoes. Another segment of midsize farms becomes involved in procurement arrangements with urban supermarket chains ([Reardon et al., 2003](#)). This restructuring of farm size distribution does not imply, however, that the bargaining position of local smallholder producers has fundamentally changed, since delivery conditions, quality norms, traded volumes and prices remain largely determined by (inter)national buyers.

A second important change in the local organization of commodity trade refers to the growing importance of so-called midstream agents ([Weatherspoon et al., 2004](#)).<sup>6</sup> These include (in)formal traders, warehouse owners, transport and processing firms that take care of product handling directly after the farm-gate. While forward and backward linkages have always been important to support agricultural primary production, with the growing urban population that requires regular access to safe and healthy food, the marketable surplus of food products substantially increases and substantial direct investment are made in (cooled) transport, bulking, packaging, labelling and sales promotion. This implies that a growing share of rural and peri-urban employment – particularly of women – is shifting towards midstream non-farm activities, whereas also a major part of value added is realized by midstream enterprises. [Reardon \(2015\)](#) asserts that midstream activities represent 30–40% of value added in food chains, whereas [Ruben et al. \(2022\)](#) show that wage employment in midstream activities already ranges between 45 and 75% of national value chain, thus being more important than primary production.

A third fundamental change in tropical market regimes is caused by the growing importance of product differentiation and quality compliance. Market competition is increasingly based on specific intrinsic product attributes, such as taste, colour, size, nutritional value and place of origin. Certification, labelling and branding are used to acknowledge these differences. [Gibbon and Bolwig \(2007\)](#) outline that segmentation into organic markets and speciality products creates prospects for 30–50% price premiums in export markets. In addition, national market outlets for (semi-)processed foods and beverages also shows growth of sales to emerging urban middle classes. Intra-regional trade is increasing in response to trade agreements that reduce border costs. It should be noted, however, that African markets tend to be less integrated with the world economy, and market integration still meets many constraints due to high transaction costs and risks that restrict foreign direct investments in agro-processing ([de Melo et al., 2020](#)).

These three structural changes in production and exchange conditions for tropical crops have profound implications for the dominant discourse on the role of markets for rural development and the opportunities to support smallholder farmers. While the 'privileged' segment of midsize farmers tends to receive higher and more stable prices, their net returns only slightly increase due to simultaneously rising costs for input applications. In a similar vein, there is considerable more room for women in midstream agro-processing and quality surveillance activities,

<sup>6</sup> Midstream value chain segments are sometimes defined as the 'missing middle', but this is considered an erroneous qualification of the large informal sector that connects primary production to markets. Therefore, [Reardon \(2015\)](#) introduced the concept 'hidden middle' as a better representation of this value chain segment.



but female wages usually stay far behind their male counterpart (van den Broeck et al., 2023). Moreover, the distribution of value added shares between producing and importing countries remains without much modification, and therefore wider opportunities for fundamentally restructuring tropical value chains are still highly necessary.<sup>7</sup> These structural changes make the limitations of markets for poverty alleviation explicit and raise the pressure to identify a more 'inclusive' discourse of market integration that provides better opportunities for smallholder farmers and rural families to improve their welfare.

## 5. Mixed experiences with market-reform initiatives

Market-reform initiatives that aimed to reduce rural poverty by improving the position of smallholders in tropical value chains started in the 1950s with the establishment of World Shops in Europe and the USA that promoted direct sales of artisanal products to their constituency of committed citizens (usually strongly related to church-based organizations). In the late 1980s the first experiences for fair trade labelling with third party certification started with tropical commodities such as coffee, tea, sugar and bananas (Raynolds, 2012). This certification was based on transaction arrangements with producer cooperatives that include three basic rules: (1) guaranteed floor prices for regular deliveries above the (inter)national open market price, usually combined with (2) premium payments invested in social and community services and also offering (3) support for technical advisory services.<sup>8</sup>

The design of commodity certification programs included a number of instruments to improve the conditions for product delivery that intended to support smallholder incomes and to reduce rural poverty.<sup>9</sup> In practice, however, in practice they had limited impact of farmer's incomes and community welfare (Valetto et al., 2023; Darko et al., 2017; DeFries et al., 2017). Meemken et al. (2019) finds in a meta-analysis of 97 field studies that only 20–30% of certified farmers receive higher prices than their non-certified counterparts, leading to an overall increase in household incomes by 16–22%. Jodrell and Kaoukji (2020) conclude from an evidence mapping of 151 studies that just 21% sources report on positive income, wellbeing and resilience effects.

The key instruments of the market-reform discourse are based on changing the transaction procedures through voluntary initiatives. This discourse meets several constraints, both at the level of its conceptual design and during their operational implementation. Even while some differences between commodities and particular locations can be registered<sup>10</sup>, three major limitations can be acknowledged:

- *Guaranteed floor prices* for the delivery of the produce aim to offer income security to smallholder farmers, but in practice income effects remain rather small. Even while minimum prices of certified products are usually higher than market prices, field evaluation studies confirm that this leads to modest income and welfare improvements for smallholder farmers, whereas positive impacts for food security are scarcely registered (Knöblsdorfer et al., 2021;

Darko et al., 2017). This is mainly due to the fact that only part of total farm-household income is determined by commodity sales, and an even smaller share of production can be sold under certified conditions. Income derived other activities (i.e., food crops; off-farm employment; remittances) may be reduced due to specialization in certified crops, thus eventually even limiting farmer's resilience (van Rijsbergen et al., 2016). In a similar vein, smallholder wages did not improve much either (Meemken et al., 2019). Living income for smallholders and living wages for farm workers cannot be reached just by improving prices or yields and need more substantial changes in land ownership and labour markets (Waarts et al., 2021).

- *Premium payments* provide rural cooperatives and communities with critical resources for making investments in social services (education, health care, drinking water & sanitation) and improvements in common infrastructure (roads, energy, houses, processing plants, etc.). This is by far the most important impact area of certification and proved to be helpful for supporting farmer organizations, but low levels of women's participation and limited accountability are to a large extent responsible for less effective use of premium resources. Cooperatives play an important role in strengthening farmer's bargaining position vis-à-vis local traders and moneylenders, and create economies of scale and scope in local processing and quality upgrading. In practice, however, few cooperatives contributed to more entrepreneurial attitudes and their engagement in risky investments remains low (Fernandez-Guadano et al., 2020). Contrary to expectations, the position of women at community and household level only marginally improved from this engagement in collective action (Hutchens, 2010; Rice, 2010), and the instrument of premium payments could increase intra-village inequality and become a source for internal conflicts and social disarticulation (Loconto et al., 2021).
- *Supporting Good Agricultural Practices (GAP)* and improving natural resource management are key instruments to increase productivity and/or quality of the produce and may reinforce the smallholder farm-household sustainability. This involves training and technical assistance at group-level (Farmer Field Schools), horizontal information exchange between farmers (farmer-to-farmer programs) and on-the-job training through individual farm-level extension visits. Important progress is reached in improving yields through better soil management, improved fertilization practices, plant maintenance and tree renovation, and pest and disease control amongst certified producers (Makita, 2016). Adoption of such technologies mainly provides opportunities for midsize and large producers to improve their competitiveness, but they are less accessible for smallholder farmers.<sup>11</sup> Moreover, returns to investments in good agricultural practices are still rather low during the initial period of implementation. Under conditions of scarce resources, investments in GAP will reduce the diversification of income sources and may thus affect the resilience of rural households.

There is wide evidence that different certification initiatives face critical constraints that severely reduce their effectiveness (Krauss and Barrientos, 2021; de Lima et al., 2021; Van Dam, 2015). They rely essentially on efforts for changing the dynamics of commodity markets, without fundamentally challenging the unequal exchange conditions between producers, traders and processors in the value chain, nor the intra-household power relationships that exclude women from most of the decision making (Lyon et al., 2010; Rice, 2010).

These voluntary initiatives meet three structural limitations that reduce their prospects for changing the performance of tropical value chains. The first structural constraint is related to the unequal

<sup>7</sup> The producer's share in market prices of tropical commodities is usually no more than 6–8% (coffee), 3–4 % (cotton) and 1–2 % (cocoa). Speciality products and organic varieties receive somewhat higher share.

<sup>8</sup> There are important differences between certification schemes. Only Fairtrade uses guaranteed floor prices and social premia, whereas Rainforest Alliance (now merged with former Utz Certified) focuses on price benefits for farmers related to more sustainable production practices or higher quality (Ruben, 2017).

<sup>9</sup> Independent third-party agencies are in charge of verifying compliance with these production and delivery conditions.

<sup>10</sup> Market reforms tend to be more effective for poverty reduction in resource-scarce countries (Jayne et al., 2019) and have more possibilities for reaching impact in commodity chains that are less fragmented and have more opportunities for grassroots farmer organization and women participation (Fernandez-Guadano et al., 2020).

<sup>11</sup> Several sustainability practices (such as mulching, composting, manual weeding, etc.) are highly labour-intensive and thus compete with smallholder engagement in off-farm employment opportunities.

distribution of value added throughout the supply chain. For tropical commodities such as coffee, cotton or cocoa, primary producers usually do not receive more than 5–7% of the market price, whereas traders, processors and retailers capture a major share of total value added. This is due to the fact that the bargaining power of the large number of suppliers remains severely limited vis-à-vis the dominant position of a small number of licenced buyers who can set farm-gate prices in advance of delivery and thus limit market competition. Efforts are made to support the payment or living incomes and living wages, but most local farmers and workers are not able to reach a minimum package of basic needs (Waarts et al., 2021). This requires eventually a redistribution of added value and full restructuring of value chain relationships.

The second structural limitation is caused by unbalanced organization of value chains, where certification initiatives compete with open market exchange opportunities. Whereas an increasing number of farmers has become engaged in certification of their production, only a small share (up to 30–40%) of certified coffee is sold under preferential conditions. This over-certification illustrates growing farmer's interest in engaging into particular market segments but also their inability to restrain access based on highly competitive supply-side conditions. de Janvry et al. (2015) show that coffee cooperatives in Central America could only sell 15% of the certified harvest at fairtrade prices. DeFries et al. (2017) show that worldwide 40% of all coffee production is certified, but only 12 % is sold under standard compliant conditions. When the certified production exceeds the uptake possibilities by market, this is provoking side-sales by certified producers that prefer to deliver to the open market if prices are temporarily higher (Alemu et al., 2020). Consequently, the total production and market share of certified products remains fairly limited.

Thirdly, the willingness to pay for certified products by consumers in importing countries is gradually increasing, but still remains small (Kossmann, 2022). Only a small segment of all consumers possess some basic knowledge on the meaning of labelling, and their main interest is in specific type of products that are produced organically or have special quality characteristics (taste, smell) related to the production methods used at the origin. Choice experiments across countries find that consumer are willing to pay some \$1.36 extra for a pound of certified coffee (Abdu and Mutuku, 2021). The larger the price premium offered to local producers at the beginning of the value chain, the smaller the segment of consumers that show willingness to pay. Growing reliance on multi-labelling of environmentally friendly or socially fair may cause a further decline in consumers' trust and willingness to pay overtime.

Given these structural limitations smallholder farmers of tropical commodities need more than just a 'reform' of the exchange conditions, since the market organization itself represents a major barrier to development. While the discourse shift towards market reform strategies might have supported a more 'privileged' segment of midsize producers, the overall effects on rural development remained limited for most smallholder farmers. It is therefore important to better understand which innovative strategies are available that enable smallholders to structurally improve their competitive position at local, regional and international markets and that inform on how to support their bargaining position in tropical commodity value chains.

## 6. Inclusive strategies for value chain transformation

In recent years, different efforts are made to deepen or strengthen the market-based initiatives making use of complementary pricing procedures ('True Pricing') or extending commitments to upstream value chain agents ('FairChain'). This coincides with a more general discussion on 'just transitions' that recognizes the need for more structural reforms of agrifood systems in response to climate change, guaranteeing the participation and protection of the livelihoods of poor farmers and consumers (Baldock and Buckwell, 2021; Anderson, 2019).

True pricing makes efforts to include environmental externalities (due to resource degradation, climate change and biodiversity loss) and

to compensate for negative social effects (wages below living standards, unhealthy labour conditions and gender discrimination) into the market price of agrifood commodities, contributing to greater supply chain transparency (Adelhart Toorop et al., 2021). FairChain goes a step further and advocates for equal partnerships and business models that contribute to better distribution of wealth and revenues across all participants in the value chain.<sup>12</sup> This may require greater engagement in processing at the producer end of the value chain, or direct delivery contracts with a selected group of consumers (that eventually can also become shareholders). Both approaches still rely on market-driven changes in the interactions between producers and consumers.

The search for agrifood system innovations that guarantee a more equal distribution of benefits and support adaptation to environmental challenges of climate change and biodiversity loss requires a fundamental new discourse. The growing attention for inclusion and sustainability asks for an institutional transformation discourse that incorporates two key dimensions: (a) the involvement of a large number of value chain stakeholders with different degrees of power and sometimes opposing interest, and (b) the need to guarantee long-term commitments of all stakeholders involved with the selected change pathways (Rotmans et al., 2001).

These conditions imply that a fundamental transformation of agrifood value chains is required based on a combination of technical, socio-economic and behavioural change. The technological component relies on sharing of best practice technologies and open access to market information (prices; quality requirements) to reinforce the bargaining position of smallholders. The socio-economic component is grounded in improved value chain governance regimes, either through long-term commitments based on delivery contracts for guaranteeing transparency and reliability or through co-ownership structures that warrant joint responsibility. Finally, the behavioural component delivers insurance mechanisms that reinforce mutual trust and reduce risks for enhancing further engagement in collective action (Jagers et al., 2020).

Translating these principles into practice implies a discourse shift towards full transformation of tropical value chain, with important institutional implications at different levels (Guarín et al., 2022; Sridharan et al., 2017). Three instruments are commonly mentioned as being critical for anchoring these changes:

- *Profit sharing arrangements* between primary producers and traders/retailers, based on pre-finance of initial production costs and direct payments with regular cash transfers during the cropping cycle. This is particularly helpful to reduce risks for poor producers and to enhance their insurance against unexpected shocks. Long-term contract between producers and traders are required that clearly define mutual commitments and include safeguarding mechanisms for resolving conflicts. Cooke and Mukhopadhyay (2019) document how unconditional cash transfers of US\$ 1.000 - delivered in three (mobile phone) instalments to coffee farmers in eastern Uganda - result after 12–15 month in a 40% increase in household consumption and almost doubling of coffee revenues. In a similar vein, Gitter et al. (2011) show that conditional cash transfers for coffee farmers in Mexico proved to be highly effective for mitigating the negative effects of falling coffee prices on early childhood development. Other experiences with monthly cash transfers to cocoa farmers in Ghana indicate that the engagement of children in hazardous work strongly declined for households receiving a monthly amount ranging between US\$ 18 and US\$ 37 (ICI, 2022).
- *Support shorter and more circular value chains* by reducing the number of intermediaries and strengthening commitments between stakeholders, in order to decrease the transaction costs for exchange, to reinforce mutual trust and to control losses and waste throughout the

<sup>12</sup> This is sometimes also labelled as 'Direct Trade' based on delivery contracts between producer organizations and processing industries.

value chain.<sup>13</sup> For many tropical commodities this implies that a greater share of production is sold on local, national and regional markets. This asks for public investments in infrastructure to enable better rural-urban linkages and stronger interactions between value chain stakeholders for internalizing environmental costs (Canfora, 2016). Circularity contributes to lower post-harvest losses due to improved storage and handling practices that may result in 20–50% reduction in quantity losses and up to 70% reduction in quality losses for major perishable products (Stathers et al., 2020). Most of these circular agrifood systems need technologies and management systems that enable re-cycling of by-products and re-use of residues in order to reduce emissions and reach zero waste (Farooque et al., 2019).

- Increase *local processing* of tropical commodities to guarantee that a greater share of value added remains in the origin countries and that producers can benefit from forward linkages with processing plants (Talbot, 2002). This strategy also contributes to the generation of additional off-farm employment opportunities for rural households and may thus strengthen their income diversification. Reaping the benefits of more local processing is only feasible when trade barriers of Western countries are broken down by eliminating the high import levies on processed goods. Experiences with local coffee roasting and packaging in Ethiopia and Kenya show that up to 50% of value added can remain in the origin country (Moyee, 2023). Naydenov et al. (2022) confirm that in Ghana there are wide opportunities for further cocoa processing into cocoa liquor, powder, butter, and paste and for manufacturing of chocolate products, but currently only half of the installed processing capacity is used, mainly due to the high costs of importing complementary inputs (sugar, powder milk, and package materials) and also because exports of locally processed cocoa products are hampered by non-tariff barriers and resistance from Western chocolate manufacturers.

In essence, these contractual exchange mechanisms contribute to structural change in the bargaining relationships between value chain stakeholders that ultimately may result in the empowerment of bottom-of-the-pyramid segments and redistribution of value added in their favour. This discourse goes further than just adjusting technical production conditions (access to inputs), but also involves fundamental changes in socio-economic exchange conditions (access to markets and prices) along with improvements in underlying behavioural relationships (trust, loyalty, etc.). The – still limited – emerging empirical evidence points towards a great potential for contract-based market reforms that can be exploited through new alliances between producers and traders that address market governance beyond simple adjustments in exchange relationships.

The feasibility for making such transition in tropical value chains strongly depends on a set of enabling factors. It asks for strong engagement in public investment by governments in producing and exporting countries (partly funded from export taxes), while public authorities in importing countries should refrain from import levies on more processed products. In a similar vein, private sector enterprises should be willing to engage in long-term procurement contracts with local producers and develop a system of direct payments that returns part of the profits made at the end of the value chain back to primary producers at the very beginning of the value chain. This cost and benefit sharing is likely to generate positive pay-offs in terms of more stable deliveries, higher quality performance and better responsiveness to emerging market opportunities.

Involving multiple stakeholders into a collective action framework

for value chain transformation is unlikely to happen spontaneously. It requires decisive support from civil society organizations – such as farmers unions and NGOs – for overcoming the sunk costs of lumpy investments in local processing and for diffusing technological improvements in farming systems. In addition, full engagement of all commercial value chain stakeholders into these novel institutional arrangements will only take place when behavioural conditions for sharing risks, reinforcing mutual trust and respecting long-term reputation are satisfied in such a way that structural barriers can be overcome and stakeholder expectations are met (Glover et al., 2019). This alliance of discourses asks for an adaptive strategy to identify opportunities for linking better the intrinsic drivers of stakeholders behaviour to different types of effective extrinsic incentives.

## 7. Outlook and implications

In this article we discussed key differences between three different discourses for rural poverty alleviation through better engagement with market exchange mechanisms. Whereas most trade in tropical commodities is still organised under relational exchange conditions, market-reform initiatives that opt for transactional exchange delivered mixed and mostly modest results. Therefore, attention is gradually shifting towards more fundamental institutional reforms in market governance structures that involve important changes in bargaining power and value added distribution amongst value chain stakeholders.

Such discourse shift is not likely to take place if only some minimum leverage conditions are fulfilled. It needs first of all decisive support from a political economy viewpoint, based on specific interest coalitions and stakeholder alliances that favour structural change. In addition, changes in market governance require a combination of public investments (for market infrastructure) with civic-driven organization (cooperation and contracts) and private networks (for profit redistribution along the value chain) that are able to integrate sustainable business practices with inclusive value-driven trade arrangements.

The emergence of this new discourse is timely, since we notice in international debates on strategies for pro-poor rural development that there is a growing scepticism against the opportunities for reforming agricultural markets as a feasible instrument for supporting inclusive growth. Whereas inclusion into markets has long been advocated as an important pathway for overcoming poverty, it is increasingly acknowledged that more fundamental changes are required to reform the structure and performance of rural markets and to support the adaptive behaviour and responsiveness of smallholder farmers.

This article provides new insights into the drivers for the discourse shifts from market-based reforms to a more transformative discourse. It outlines that growing evidence on the – frequently disappointing – welfare effects of market-based reforms drives the discussion towards more fundamental structural reforms. Moreover, better understanding of the real impact of different reform measures for different value chain stakeholders paves the way for an institutional analysis of the prospects for improving market governance mechanism.

In this article we identified the importance of market governance at three different levels. First, agrifood markets shape relational exchange relationships between producers, traders and processors that are based on substantial power differences and therefore are likely to result in unequal outcomes. Supporting inclusion thus requires changes in these interaction networks. While premium payments already represent an important initial break with spot exchange, engaging enterprises in profit sharing would imply a new bargaining framework for reducing market risks and improving transparency. This is usually accompanied by further changes in the agrarian structure, especially the rise of midsize farms under contract farming arrangements.

Secondly, the price volatility that is intrinsic to agricultural commodity markets represents a major barrier for the upgrading of smallholder farms, since it keeps willingness to investments at a low level, reduces prospects for intensification and forces farmers towards (on and

<sup>13</sup> A short supply chain is defined as a supply chain involving a limited number of economic operators, committed to cooperation, local economic development, and maintaining close geographical and social relations between food producers, processors and consumers.



off-farm) activity diversification. Therefore, minimum price guarantees provide a useful contribution for improving foresight and create a wider time horizon, thus enabling more in-depth investments in farm upgrading. This may ultimately also strengthen the relationships between farmers and midstream agents that are involved in processing and trade. Agricultural production and trade networks that are based on closer integration and more circular resource flows not only limit transaction costs and risks, but also reduce losses throughout the value chain.

Third, it is important to guarantee that innovations and investments result in better outcomes at farm level and are equally distributed within the household. Improving agricultural yields is therefore important, but not sufficient. Implementing good agricultural practices should also lead to higher net revenues, improved land- and labour productivity, and better rewards for the labour force. This can only be expected when farmers engage in quality upgrading of their production and start adding value through local processing, thus receiving better prices and capturing higher margins. This last outcome is therefore a condition for enforcing profit sharing arrangements in primary production.

These structural changes in the organization, governance and performance of agrifood markets need to be accompanied by adjustments in research and policy agendas. Agricultural research priorities should shift from searching improved production technologies to opportunities for bringing more justice to value chain relationships. Therefore, interactions between investments, knowledge and power are likely to change. At policy level, strategies for value chain integration and commitments to responsible entrepreneurship should receive major attention, looking at responsibilities for emission reduction and adaptation to climate change, while guaranteeing living incomes and decent working conditions. New blockchain and information technologies could in this respect be helpful to support value chain transparency.

It is beyond doubt that such market system reforms are urgently required to strengthen global international coalitions for reaching the sustainable development goals (SDGs). In addition to public investments and voluntary action, it is of utmost importance to mobilize business resources and enterprise engagement with market reforms that fundamentally change the pattern of interactions and create prospects for more equitable and inclusive development outcomes.

### CRedit authorship contribution statement

**Ruud Ruben:** Writing – review & editing, Writing – original draft, Visualization, Resources, Methodology, Investigation, Formal analysis, Data curation, Conceptualization.

### Declaration of competing interest

The authors declare that they have no known competing financial interests or personal relationships that could have appeared to influence the work reported in this paper.

### Data availability

No data was used for the research described in the article.

### Acknowledgements

This article is based on a contribution to the academic conference 'Navigation Change' (June 27–28, 2023) organized for the anniversary of the Department of Anthropology and Development Studies (ADS) at Radboud University, Nijmegen (The Netherlands). Comments by the conference participants and by two anonymous reviewers is gratefully acknowledged.

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