



INTERNATIONAL FOOD  
POLICY RESEARCH INSTITUTE

sustainable solutions for ending hunger and poverty

# BRIEF 3

## POLICIES AND INSTITUTIONS

### Removing Barriers to Rural-Urban Exchange

Urbanization, trade liberalization, agroindustrialization, and the rise of supermarkets are among the trends providing farmers in poor countries with new opportunities to participate in local and global markets.

For farmers to benefit from these changes, however, they must have the resources, skills, and information needed to access and participate in these markets. In addition, rural, urban, and export markets must themselves be integrated.

But anachronistic policy mindsets, and unwise policies and investment decisions, can divide rural from urban, break economic, political, and livelihood synergies apart, and leave rural areas behind. Recent research highlights the policies and institutions\* needed to remove barriers to rural and urban exchange.

\*Here the term "institutions" refers broadly to the set of formal and informal arrangements and rules of conduct that shape human interaction. This brief focuses on institutions that affect interactions in the economic market.



## FINDINGS

### 1 Policies and institutions need to be grounded in an appreciation of the synergies that exist between urban and rural areas and of the benefits that come from encouraging the free flow of resources between them.

For instance, economic growth strategies of mid-20th century China and India viewed rural and urban areas practically as separate spheres of action. They perceived rural as backward and urban as modern. China's strict controls on migration underscored this separation.

Reforms in China beginning in the late 1970s and in India in

the 1990s started to liberalize markets and movement. With more movement of resources, including labor, and better links with urban areas, agricultural growth in China boomed, running at 7 percent per year from 1978 to 1984. Urban industry outsourced work to rural areas, increasing agricultural and industrial output and employment.

### 2 Market liberalization alone is not sufficient to integrate rural and urban markets. Well-functioning markets also require efforts to minimize the cost of exchange between rural and urban areas. In addition, market actors must have the resources, information, and capacity to participate in the market.

Effective markets increase exchange between urban and rural areas and help both become more productive. Macroeconomic reforms often focus on removing market distortions caused by price interventions. Yet effective markets also require minimizing the costs of exchange, or transfer costs.

Even if market mechanisms work well, individuals and busi-

nesses must have the capacity to actually participate in the market. Investment in education and business training, plus better access to credit, can help those who may otherwise be excluded, such as the poor or small farmers, to compete in the marketplace. The legal system must also allow for confidence in and enforcement of contracts.

### 3 Buyers and sellers will not interact if it costs more to trade than the trade is worth. In many countries, poor infrastructure and institutional barriers increase transfer costs, limiting interaction of rural and urban producers and sellers.

Five major types of transfer costs impede market exchange:

- a. Information asymmetry: one participant in the transaction has more market information, especially on prices, than the other, and uses it to his or her advantage
- b. Transaction costs: taxes, fees, bribes, and time spent to accomplish transactions
- c. Costs of transport and communications
- d. Policy-induced barriers: suboptimal institutional arrangements, including governance issues
- e. Noneconomic barriers: lack of education or social customs and laws that exclude certain groups, such as ethnic groups or women, or give other groups special advantages

## 4 Policies and investments to reduce transfer costs include addressing institutional constraints as well as improving infrastructure.

Good transport infrastructure and institutional arrangements help agricultural producers and other businesspeople overcome barriers to the flow of goods, services, and resources between rural and urban areas. Helpful institutional arrangements include mechanisms to coordinate action across tiers of government, appropriate governing structures, laws and regulations, and sound financial and information networks.

Ways to positively address the five major types of transfer costs include:

**a. Modernizing the food value chain and reducing intermediaries addresses information asymmetry.** With a modernized food value chain, supermarkets and agribusinesses can deal with producers and consumers directly. With fewer intermediaries, traders have fewer opportunities to exploit or garble information, and farmers can reduce the time spent searching for and verifying information. With closer connections to consumers, businesses can give guidance on what should be grown—for example, telling Indonesian producers what kind of green pepper a consumer in Jakarta wants.

Of course, policies must ensure that supermarkets or agribusinesses do not monopolize information, markets, or technologies. Farmers still need to be able to choose which products they grow, verify information independently, and seek the best deal from a variety of clients. Competition among buyers can improve the quality of information.

**b. Producer cooperatives can lower transaction costs.** Small farmers may need to band together to pool risks and create economies of scale that allow them to compete with larger producers or bargain with vendors who may prefer dealing with only one large producer. Though some cooperatives become managerially top-heavy and welfarist, many provide significant benefits to their members. Dairy cooperatives in Ethiopia have aggre-

gated producers' production to supply the high quantities demanded by city markets. They have also invested in marketing and processing services that did not make economic sense for individual farmers operating alone.

**c. Better telecommunications can ease costs of transport and of obtaining information.** Reliable, affordable, convenient telecommunications strengthen economic synergies. Producers can access market information they need. Urban businesses can reduce search costs among rural suppliers. In a study of village telephone use in Bangladesh, almost all calls went to urban areas. One-third of calls were for business purposes (getting market information, making deals), 27 percent were to family and friends (sometimes also business-related), and 10 percent were to look for a job. But distance has a major impact on use. Sixty-four percent of individuals who lived in the village with the phone used the phone, whereas only 27 percent of those who lived half an hour away did.

**d. Appropriate governance structures can lower policy barriers.** Even well-intended policies can create barriers. In Ethiopia, for example, localities received some taxing authority to improve the effectiveness of decentralization policies. Several local and regional authorities, however, set up checkpoints at their administrative borders, charging fees that substantially increased the time and cost it took to transport grain from producer to market.

**e. Systematic attention to discrimination based on gender or caste can address noneconomic barriers.** Discrimination can limit exchange between urban and rural areas and so reduce competition. Social customs may prohibit women from traveling or working. Local authorities may exclude indigenous or low-caste communities from decisionmaking or restrict certain jobs to specific groups.

## POLICY INSIGHTS

Weak market institutions can hinder economic interaction between urban and rural areas. To help resources flow to where they will do the most economic and social good, policies need to:

- overcome misconceptions in planning and decisionmaking processes that separate rural from urban and diminish the importance of promoting urban-rural links;
- complement removal of price distortions in markets with investment in physical and social infrastructure and reduction of institutional barriers to rural-urban trade;
- provide potential market participants, especially marginalized and vulnerable groups, with the mechanisms, knowledge, and right to participate in markets; and
- pay special attention to areas where markets are missing or not competitive and may need regulation or assistance to overcome institutional barriers.

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*Text written by James Garrett based on the following background papers:*

Chowdhury, Shyamal, Asfaw Negassa, and Maximo Torero. 2005. *Market Institutions: Enhancing the Value of Urban-Rural Links*. FCND Discussion Paper No. 195, and Markets, Trade and Institutions Division Discussion Paper No. 89. Washington, D.C.: IFPRI.

Fan, Shenggen, Connie Chan-Kang, and Anit Mukherjee. 2005. *Rural and Urban Dynamics and Poverty: Evidence from China and India*. FCND Discussion Paper No. 196, and Development Strategy and Governance Division Discussion Paper No. 23. Washington, D.C.: IFPRI.

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