Inclusion, exclusion and adverse inclusion: what are policymakers missing?

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Inclusion, exclusion and the cure for poverty

- Here is a simple truth: how we understand the problem determines how we define the solution.
- The problem of poverty in South Africa – particularly in respect of small black enterprises – is generally defined as historical exclusion: "we were not allowed to participate in the mainstream economy, and so we were poor."
- The two economies conceptualisation of South Africa supported this viewpoint: a poor majority stuck in one economy, isolated from the other.
- In this worldview, the cause of poverty is exclusion, and so the cure is inclusion: if enough people are included into the mainstream economy we will solve poverty
- This thinking permeates policy to support and grow small and emerging black farmers, by integrating them into big, formal value chains

But was poverty in South Africa always down to exclusion?

- Inclusion – particularly into dominant value chains – is seen in almost every development programme as THE cure for poverty.
- But as Ponte, Hickey, du Toit and others point out, were people poor in South Africa because they were genuinely excluded from the mainstream economy?
- Were farmworkers poor because they were excluded?
- Were mineworkers poor because they were excluded?
- Were domestic workers poor because they were excluded?
- In reality, most South Africans have never been completely "excluded" from the economy – almost all have always participated, in one way or another.
- So why were they poor when other participants (such as white mine employees) were not?

The terms of inclusion matter much more than inclusion itself

- As Ponte points out, it is the TERMS on which inclusion takes place that determines the impact on poverty, rather than the fact of inclusion or exclusion.
- Those who are included on preferential terms will prosper, and those who are not, will not.
- This observation raises the possibility of "adverse Inclusion" – that one might be included into a particular market, but not prosper from that inclusion. In fact, inclusion might make you worse off than before.
- If we consider the empirical evidence on this subject with respect to small-scale and emerging farmers (including land reform beneficiaries) we will discover that adverse inclusion outcomes are in fact MORE common than beneficial inclusion outcomes.
- BUT – policy is still largely based on the assumption that inclusion is always beneficial

What drives adverse inclusion outcomes?

- Adverse inclusion theorists do not make the claim the inclusion into established mainstream markets is ALWAYS bad, merely that the very real possibility exists that it may be.
- The implication is that we cannot make *a priori* assumptions about the outcomes of inclusion – it is always an empirical question
- The current research indicates that the actual outcomes of inclusion are the result of the combination of two factors:
  - The terns on which smaller producers are included; and
  - Their ability to deal with those terms of inclusion.
- The more detrimental the terms, and the less the enterprise is able to deal with the impact of those terms, the more likely an adverse inclusion outcome, and thus the more likely it is that a policy of indiscriminate value chain inclusion is contributing to poverty.

The terms of inclusion

- Value chains are not benign organisations of companies working for the common good – they are a fight to the death to extract more value than anyone else in the chain. It is power in the value chain that determines who gets access to that value
- Big supermarkets (and in South African big processors) wield huge power because of their market share, which means they can effectively dictate terms to suppliers and thus increase their own margins – where else will they go?
- Terms include low prices, additional fees, carrying a greater share of the packaging costs, subsiding costs of promotions, subsidising costs of losses/shrinkage, slotting fees, variation orders, etc.
- Smaller producers are particularly poorly equipped to be able to deal with these terms, given their lower level of output and limited access to capital.
- The result is that inclusion into these value chains often means that the small producer is either trapped in a relationship that keeps her poor, or may even go out of business entirely.

Why does this matter?

- You may believe that this is a moot point – that some participants in a particular market survive and some fail, so what is the big deal?
- The big deal is that a considerable amount of taxpayers money is being directed towards market inclusion strategies, on the basis that these are the "cure" for poverty, when they are anything but that.
- Hundreds of millions of Rands is being spent to "support" small-scale farmers to become suppliers in markets where they can never succeed. Almost as much money is spent propping up these farmers to compensate for the detrimental terms of inclusion. These funds essentially represent a taxpayer subsidy of the lead firms in these value chains.
- The big deal is that we will never address rural poverty unless (smallholder) farming becomes a more profitable and sustainable business.
- Countries like the UK have recognised the enormous public cost of a dying rural economy because of adverse inclusion – how much higher are the costs in South Africa?

What needs to be done?

1. Policy in respect of developing farmers and agricultural enterprises needs to fully acknowledge the possibility of adverse inclusion outcomes, and address that possibility in the *pre-planning feasibility* stage of any proposed initiative.
   - This means paying close attention to farm-level income and risk projections

2. Exploitative value chains are not the only value chains available to smaller producers, nor are they the only way to access markets, but they are the biggest and the most visible. Policy needs to pay more attention to the pro-poor possibilities of two strategies:
   - Alternative value chains; and
   - Producer upgrading

3. The worst of the excesses can be addressed by regulation, reflecting what has been done in the UK

4. Updating BBBEE regulations to reflect the possibility of adverse inclusion

The UK example

- Following two Competition Commission Enquiries, the UK introduced a compulsory code of conduct for grocery retailers. This was based on a definition of abusive practices that reflected the idea that uncompetitive behaviour could take place on a vertical plane as well as a horizontal one.
- This has made a large number of standard practices towards suppliers illegal.
- In addition, a Groceries Code Adjudicator has been set up. This office investigates complains by suppliers and takes remedial action of necessary.

https://www.gov.uk/government/organisations/groceries-code-adjudicator

THANK YOU