

The Washington Consensus on Poor Country Agriculture: Analysis, Prescription and Institutional Gaps

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This article reviews the analysis and prescriptions of the current 'Washington Consensus on Agriculture' (WCA). The WCA contains much that is to be applauded, but there are also gaps and inconsistencies within and between the analysis of current problems and the prescriptions to address them. It is suggested that the worrying decline in aid to agriculture is related to gaps in the WCA, which fail to point to important avenues of intervention. The gaps lie mainly in the field of 'institutional development' (as this term is defined here).

The Washington Consensus (WC) was identified by Williamson (1994) as a set of analyses and prescriptions which might be thought of as the World Bank/IMF orthodoxy of the day. In the spirit of Williamson, but focusing on the agricultural and rural sector, this article examines the current 'Washington Consensus on Agriculture' (WCA).¹ Although there is much to be applauded, there are also gaps and inconsistencies which partly explain current difficulties with policies and interventions to promote agricultural development in poor rural areas.

The WCA: A composite analysis

Description

In recent World Bank policy documents (for example, World Bank, 1997; World Bank, ADB, UNECA, 2000) a number of themes recur to explain situations where the agricultural sector has failed to realise its potential in bringing about rural development and poverty reduction.

Fundamentally, the agriculture of poor regions is said to be 'undercapitalised' and insufficiently competitive in the world market. Behind this lie adverse resource endowments (including high vulnerability to plant and animal diseases), a skewed distribution of resources and 'policy and institutional' failures. These three are linked. In particular, institutional and policy failures impact on resource endowments, productivity and management, as well as on the wider workings of society and national and rural economies.

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1. This is not the first time WCA has been used as a conceptual device, see Maxwell (1998); Maxwell and Heber-Percy (2001).

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Published by Blackwell Publishers, Oxford OX4 1JF, UK and 350 Main Street, Malden, MA 02148, USA.

'Institutional' failures are seldom well defined, but discussion in the WCA tends to focus on the effectiveness of political institutions and the organisational capability of governments (including issues such as freedom of association, transparency, accountability and the extent of devolution of decision-making) and the strength and effectiveness of civil society organisations, such as farmers' organisations and NGOs. Policy failures are generally conceptualised as the suppression of agricultural incentives through: (a) 'economy-wide' policies (i.e. macro, trade and industrial policies) which discriminate against agriculture; (b) excessive explicit taxation of agriculture (mainly via commodity levies); (c) support for agriculture that has been quantitatively inadequate while also inefficient, the latter because of excessively state-dominated and centralised rural service provision delivered through structures that are prone to rent-seeking and discourage the emergence of private services; and (d) urban bias, which is a policy failure consequent on the weaknesses of political institutions.

Particular emphasis is given to agricultural marketing policies and services where parastatals provided services to farmers in output and input markets and seasonal finance, often on the basis of monopoly. This resulted in: (a) high operational inefficiency (paid for mainly by low output prices and/or a fiscal burden on central government); (b) failure to develop competitive supply chains; and (c) weak links with the international market, causing loss of market share in traditional exports and inhibiting diversification into crops and processed products with more promising price prospects.

Failures in agricultural finance services are recognised as an important cause of the under-capitalisation of agriculture, with general policy failures suppressing farmers' incentives and inhibiting private and public agriculture-related investment, and weaknesses in rural financial systems failing to stimulate and capture agricultural savings and to channel these to agricultural investment.² Insecure property rights, principally in land, are also seen as significant factors in some areas, inhibiting investments in land improvements and the use of land and buildings as loan collateral.

Some of these problems can be related to the stylised 'political economy of low density rural areas' (Binswanger and Deininger, 1997) whereby (a) such rural economies are relatively unspecialised and so rely on incentive-depressing interventions in agricultural markets for taxation; (b) transactions costs are very high, due to poor transport and telecommunications infrastructure; and (c) low population density also raises 'political transaction costs', making it easier for the urban elite to resist pressure to address urban bias.

Finally, OECD countries' agricultural and trade policies are recognised to be seriously unhelpful by: (a) limiting market access for exports; (b) depressing world market prices for key commodities; (c) causing greater price volatility on world markets; and (d) maintaining tariff escalation, which inhibits the development of value-added processing within poorer countries.

Despite these difficulties, there is a supposition that smallholder (family) farming is a fundamentally efficient mode of economic organisation in poorer countries, the potential of which has been seriously inhibited where there have been economy-wide policy biases against agriculture, often reinforced by biases within the sector towards

2. Also it is unlikely that inter-sectoral and/or international financial flows can play the predominant role in capitalising small-scale agriculture.

larger farms (private, state, collective). This rests on the view that smallholder farming is the most effective form of organisation for engaging and motivating labour in agriculture, because the operating family is the claimant of the residual surplus and because it encourages farm operators to acquire and apply locally-specific agro-ecological knowledge.

Prescription

Arising from this analysis, a key requirement put forward for developing and harnessing the potential of poor country (and specifically smallholder) agriculture is 'agricultural systems intensification', meaning increased farm productivity based on the development and application of new and improved technology. This is a long-standing objective (see Ellis and Biggs in this volume) which, in the past, has been pursued by government programmes focused on technical constraints and specific crops. From here on, it is argued, much greater emphasis should be given to private sector incentives; sustainable resource management; commodity diversification; decentralisation; and the participation of farmers in setting objectives, conducting research and evaluating results.

Much can be achieved, it is argued, by continued improvements in economy-wide (i.e. macro, trade and industrial) and agricultural policies, especially the reduction of tariff and non-tariff barriers to imported agricultural inputs. Small and medium-sized countries should also reduce intra-regional trade barriers and put more emphasis on regional co-operation in agricultural research and plant and animal disease control. More reforms are needed in taxation policy, based on a move to non-discriminatory forms of taxes (e.g. VAT, broad-based consumption taxes) which will reduce the reliance of central and local governments on commodity levies.

Much better services are required in the delivery of agricultural public goods and services to poor rural people. New approaches could be based on public-private partnerships. These could involve, as appropriate, central, regional and local government working with the private and voluntary sectors. Decentralisation gives government decision-makers better information about local circumstances, allows electors greater access to services, and enhances accountability.

Reform of input supply (there is less concern about the performance of output markets) requires a review of existing formal and informal barriers to entry and also a credible commitment by the government to keep out of the market. Market-based, government-facilitated land reform may also be important where land ownership is highly skewed. Aid donors should also consolidate the present emphasis on programme or budget support (e.g. via Sector Investment Programmes), avoiding balkanised projects.

Finally, OECD countries should reform their agricultural and industrial policies substantially to reduce the distortion of world markets and tariff escalation; to prevent sanitary requirements being abused as non-tariff barriers to poor country agricultural exports; to provide more assistance to countries to enable them to use their membership of the World Trade Organization to fight unfair trade practices; and to encourage foreign direct investment in agriculture and related activities.

Gaps in the WCA

The analysis and prescription of the WCA contain much that is to be applauded. There are, however, gaps and inconsistencies within and between the analysis of current problems and the prescriptions to address them. Together, these lead to an ‘agricultural investment dilemma’ facing governments and donors concerned to reduce rural poverty: namely, that, despite recognition of the great importance of agriculture in rural development and poverty reduction, the WCA analysis and prescription, with this emphasis on broader policy and institutional issues, makes it difficult to design and gain approval for specific public sector investment programmes which directly support agricultural development. It is not surprising, therefore, that agricultural public investment should be declining, both absolutely and in comparison with rural human and infrastructural development.³

In fact, the conclusion is flawed; there are strong arguments for greater investment to support sustainable and poverty-reducing agriculture (see Irz et al. in this volume). We suggest four basic areas of analysis that the WCA does not develop sufficiently: taking these into account should modify and extend the prescription, providing strong new arguments for investments in agriculture.

Challenges vary with stages of agricultural modernisation

First, there needs to be greater recognition of the different challenges facing areas at different stages of agricultural modernisation, in particular, differentiating between those areas which have not yet experienced agricultural modernisation and those which have gone through the early stages of such modernisation, with associated development of transactions-enabling institutions and of the non-farm sector. This requires a more dynamic view of the way that policy prescriptions must change, and hence understanding that there are important differences for agricultural policy, for example in the role of the state, and between pre-modernisation areas and, for example, ‘green revolution’ areas in Asia. Further, current policy must look forward to, and not prejudice, likely future development in the structure of the agricultural sector as modernisation proceeds (see also Wiggins and Proctor in this volume).

Importance of semi-tradable cereals

Second, the analysis does not place enough emphasis on strong historical and theoretical arguments that the ‘best bet’ for broad-based and rapid rural growth and poverty reduction in poor rural areas still at the early and agriculture-based stages of development is agricultural modernisation (a term we prefer to sustainable intensification), based on increased productivity and production of semi-tradable cereals

3. World Bank (2000) reports that the rural portfolio is declining in both total lending and number of projects (agriculture, natural resource management, and rural water, sanitation and roads amounted to only about 10% of loan approvals in 2000). Furthermore, quality and sustainability are not fully satisfactory, the focus on rural poverty is less than desired, there is limited integration of, and co-ordination with, other Bank sectors active in rural space; and there has been no breakthrough in attention to ‘rural’ in the business planning process.

(see, for example, IFAD, 2001). This is not to deny the importance of growth in productivity and production of traditional and non-traditional cash crops and other food crops, nor to brush aside the many difficulties with expanding cereal production in today's poor rural areas. But, unless this issue is specifically addressed, the WCA is ignoring a critical component of the earlier stages of rural development.

Threats to underlying smallholder competitiveness and efficiency

Third, the WCA rests on a supposition that small farms are fundamentally more efficient than larger farms. However, the literature on which this supposition is based recognises that it applies in particular (if in the past widely applicable) conditions (see for example Lipton, 1993). For many small-scale farmers in poorer rural areas today, these conditions may be breaking down, where globalisation intrudes, non-traditional crops are promoted, and agricultural modernisation involves increasing use of capital.

With regard to globalisation, as less favoured areas are opened up to world trade through policy changes and institutional and infrastructure development, they face threats of greater competition from cheap imports and lower world prices than was faced by producers during the green revolution in Asia. Current projections are that world prices of grains will continue to fall (Pinstrup-Andersen et al., 1999), even though these estimates have probably taken a conservative view of the productivity-enhancing effects of GM technology in commercial farming where regulators and consumers will permit its adoption. Low food prices on world markets are good for poor consumers, but less good for poor farmers seeking to earn income from sales of food surpluses, and may reinforce a tendency to provision major cities in developing countries from the world market rather than from their rural hinterlands.

By the same token, opportunities for small farmers to benefit from wider access to new global markets for non-traditional crops are also more limited than the WCA suggests. These markets are often characterised by increasing emphasis on quality, product differentiation and timely delivery, and require relatively high levels of capital intensity in production and detailed process supervision which is responsive to rapid shifts in requirements at the retail end. The transaction costs and risks involved in ensuring quality and timely delivery are high, and cost-reducing institutional arrangements involving economies of scale and vertically integrated supply chains, principally controlled from the large retailer/importer end (e.g. supermarkets), do not favour small-scale producers. Thus, while the production end of these supply chains may make useful contributions to the rural economy and to exports and the tax base, they are unlikely to generate the large and dispersed employment gains needed for poverty reduction. This pessimistic conclusion may be mitigated by premia for organic, non-GM and ethical products defending smallholders' share of the market for some non-traditional products, although again the information costs in assuring compliance standards disadvantage small-volume producers unless they are highly organised. It is therefore important to be realistic about what can be achieved.

Improving the definition of institutional analysis

Finally, the growing 'institutional' emphasis in the WCA is welcome, but it is not sufficiently focused or far-reaching. An unfortunate ambiguity with the word

'institutions' means that it is sometimes not clear whether it is being used to describe organisations or 'the rules of the game' (the new institutional economics, i.e. 'Northian', meaning). The distinction is crucial. Even where its use in the latter sense is clear, the institutional analysis focuses largely on the 'institutional environment' (Davis and North, 1971): much more specific and consistent emphasis needs to be given to the development and evolution of 'institutional arrangements' to reduce transactions costs and risks, alongside improvements in the institutional environment and investments in, for example, communications and education (see Box). As argued below, this is important in considering constraints to, and expansion of, food crop productivity.

Institutional issues in agricultural development

Poor farmers' difficulties in accessing purchased inputs and seasonal finance for food (grain) crop production are widely recognised (e.g. World Bank et al., 2000; Kherrallah et al., 2000; Naseem and Kelly, 1999) but are paid relatively little attention in the WCA. This may be explained by the relatively low emphasis on the fundamental role of expanded semi-tradable food-crop production in rural poverty reduction, and by the current lack of any clear answers to this problem, beyond general calls for further reform of agricultural markets and the strengthening of institutions and infrastructure to increase the entry of private actors and hence competitiveness.

A more penetrating institutional analysis of conditions in pre-modernisation and modernising agriculture, however, suggests that, although these calls may be appropriate as longer-term objectives once agricultural modernisation is under way, they can be irrelevant and even damaging if relied upon in pre-modernisation situations. Thus although the WCA correctly recognises the problems, costs and frequent failures of parastatal agricultural input and credit supply in pre- and modernising agriculture in the past, it fails to recognise their potential benefits when they work. This may arise from inadequate understanding of the nature and importance of transaction costs within smallholder agriculture and their effects in seasonal input and finance markets; from lack of emphasis on the need for innovation in institutional arrangements (see Box); and from narrow sectoral consideration of the costs of getting agriculture moving without considering the possible fiscal (as well as wider social and economic) benefits of investment in growth rather than expenditure on social welfare and safety nets.

Although high transaction costs and risks are not the only problems constraining farmers' access to seasonal inputs and finance in food crop production, their reduction is necessary, if not sufficient, for access problems to be solved. We consider separately problems with input supply, input demand, and access to seasonal finance.

In the past, *input supply* was often managed by parastatals and was tied in with pan-territorial pricing and monopsonistic crop purchasing. The problems of such parastatals, their increasing inefficiency and ineffectiveness, and the growing fiscal burden they imposed are widely documented. However, as the WCA recognises, liberalisation of the input supply system has not generally led to an influx of private traders selling inputs to smallholders in marginal areas: such traders are often severely constrained by problems in accessing credit for working capital, and face high credit and distribution costs (with poor transport systems and low volumes) and uncertain returns (due to policy uncertainties, variable demand and difficulties in communicating with poor dispersed

farmers) (for example, Bryceson, 1999; Kelly et al., 1999; Reardon et al., 1999; Gordon and Goodland, 2000).

Box: 'Transaction costs', the 'institutional environment' and 'institutional arrangements'

Firms and individuals incur transaction costs in order to reduce risks of loss in transactions, trading off costs against risk to maximise net benefit (North, 1990; Williamson, 1991; Dorward, 2001). Transaction risks and transaction costs are determined by the transaction characteristics of the commodity or service transacted, the wider institutional environment, and institutional arrangements (the specific contractual forms and terms agreed between transacting parties for particular transactions) (Davis and North, 1971; Williamson, 1991).

The principal ways in which the state and other parties may intervene to reduce transaction costs and risks include

- (a) investment in communications infrastructure and in the institutional environment;
- (b) investment in some forms of non-competitive institutional arrangement (for example, supporting the development of producer groups, trader credit systems (see, for example, IFAD, 2001: 169-70) and micro-finance systems);
- (c) subsidy to contracting parties to overcome specific market failures and/or develop an industry and its institutions to the point where they are self-sustaining (for example, subsidised insurance services, market stabilisation, investment subsidies to reduce risks from specific assets, or subsidies for the development of specific institutional arrangements); and
- (d) relatively minor direct intervention to foster 'bottom-up' institutional innovation, where transacting parties develop specific forms of relationship to reduce their transaction costs and risks (for example, taking care not to impede the development of such arrangements through regulations suited to more developed, low transaction risk situations, while guarding against arrangements that constrain development or are exploitative).

The dangers of subsidies under (b) and (c) above are widely recognised, but this should not rule out the recognition of some of their benefits or preclude the possibility of, and search for, more effective and efficient interventions in the future.

Low and uncertain *demand* is itself partly caused by the poor supply system: farmers cannot rely and wait for uncertain deliveries, and may be in a weak position to negotiate prices when alternative supplies are not available locally. In addition, uncertain output prices and marketing opportunities, and relatively higher input prices (as a result of devaluations and subsidy removals), undermine the underlying profitability of fertiliser application. A widely reported and equally fundamental constraint, however, is farmers' lack of liquidity to finance seasonal input purchases.

Demand and supply problems in *seasonal finance* are widely recognised. The old 'agricultural credit model' (which fell out of fashion in the 1980s) addressed some of these, sometimes naively, with subsidised systems. Its problems, like those of parastatal marketing boards, are widely recognised, with high costs, limited outreach and financial repression making it ineffective and unsustainable (Ellis, 1992). However, the original critique recognised that it had worked in some situations (e.g. Braverman and Guasch, 1986), and state support in the provision of seasonal finance is recognised by some as

an important ingredient in successful agricultural modernisation (for example, Eicher and Kupfuma, 1998; Morris and Byerlee, 1998; Kirsten and van Zyl, 1996). We now lack alternatives to address the seasonal finance problem, and there is an urgent need to identify the possible ingredients of a solution. We can look for these in the range of institutional arrangements by which small farmers and the rural and urban poor currently access finance to a greater or lesser extent. These include micro-finance services, interlocking transactions, savings, producer groups and informal financial intermediaries.

Micro finance and rural banks are fashionable as general approaches to agricultural credit. However, the frequently cited success stories tend to be in modernising areas (with a healthy non-farm economy and non-farm incomes); tend to provide loans which are structured in ways that are inappropriate for financing seasonal crop inputs (for example, with regular fortnightly repayment installments) unless households use some other cash income stream; seldom provide evidence that they are in fact directly financing seasonal crop inputs;⁴ and where they have supported seasonal finance, tend to support less poor farmers producing cash rather than food crops (Dorward et al., 2001).

'Interlocking transactions' (Poulton et al., 1998) are an institutional arrangement in which output buyers provide inputs on credit to client farmers. This arrangement was effectively used by some parastatals in financing food crop inputs and is a means by which private traders may finance cash crop inputs. However, private traders are themselves frequently credit-constrained, and the conditions necessary for interlocking transactions to provide both farmer and trader incentives sufficient for them to operate effectively will not occur in food crop markets without some form of regulation, and are undermined by the increased competition proposed by the WCA (Dorward et al., 1998).

Savings and cross-investment from cash crops and non-farm income are important in some areas (where modernisation is under way already or where there is a successful cash crop) (see, for example, Govereh et al., 1999), but this is not working at the moment in the priority areas, and there is no reason to suppose that it will work without increased income and savings opportunities. Producer groups are another form of institutional arrangement that has had some successes (and many failures) in promoting savings and channels for transaction-cost and risk-reducing credit for food crop inputs.

Finally, informal financial intermediaries tend to be poorly financed in pre-modernisation areas, in Africa at any rate (Rutherford et al., 1999), and currently are not solving farmers' problems of access to seasonal finance (Jones et al., 1999). However, the particular institutional arrangements that they are able to develop with clients can have considerable transaction-cost and risk-reducing advantages, and there may be scope for developing institutional arrangements linking these to formal organisations with wider access to formal financial markets (Seibel, 1999).

4. Although problems of fungibility make it difficult to identify what any loan is financing, in the absence of access to equivalent cash sums (from savings, income or loans) from other sources, the options for fungibility are limited, demonstrating that either they are not supporting agriculture directly or indirectly, or their effectiveness relies on a fairly large flow of cash in the household economy.

Conclusions

There are some immediate policy conclusions that follow from this discussion. First, policies developed in and relevant to modernising areas cannot simply be transferred to pre-modernisation situations: much greater attention needs to be paid to interactions between the farm and non-farm economies and the existence and nature of different actors and institutions (the latter in terms of both the institutional environment and arrangements). Second, the problem of access to purchased input supply and seasonal finance in food crop production needs to be given more serious explicit attention. Third, output markets, input delivery and seasonal finance need to be considered together – both analytically and in policy formulation, together with other necessary conditions for their operation (for example, the current emphasis on roads, education, health and institutional environment). Fourth, subsidies may be necessary to kick-start demand and get volumes up, and it is critical that these are analysed and designed to deliver acceptable costs, minimal distortions and satisfactory exits, as well as taking account of the need for other necessary conditions to be met (such as the existence of roads, communications, and an appropriate institutional environment and set of arrangements). Fifth, the (micro-economic) institutional arrangements and transaction costs and risks in output markets, input delivery and seasonal finance need to be given as much attention as has traditionally been given to the micro-economics of production. Finally, investment decisions need to compare fiscal and economic costs and benefits with the full costs of alternatives (for example, subsidies to rural finance might be compared with the alternative of financing rural safety nets, with their distortions and lack of long-term benefits or exit strategies).

It is also important to recognise that this is an area where we do not have many answers, and any answers are likely to be variable and complex. An important research agenda therefore needs to address the following issues:

- The arguments about government failure in input and agricultural credit support need to be revisited, asking what government intervention did achieve, and what was right as well as wrong with different models. This exercise needs to compare the effectiveness, costs and benefits associated with alternative models, and recognise both direct effects and indirect (linkage) effects on non-tradable farm and non-farm activities.
- Related to the above, more information is needed about the different ways that early agricultural modernisation was financed at the farm level in Asia, the role of the state, and the way that this role and its effectiveness, costs and benefits changed over time.
- Detailed examination is needed of the institutional lessons from elements of successful public sector programmes and private sector activities, in order to identify critical characteristics, the conditions under which they may work, and how the advantages of different institutional arrangements can be most effectively combined.
- Action research is needed in institutional innovation, pulling in experience and trying out innovative institutional arrangements involving, for example, elements of interlocking transactions, producer groups, regulated monopsony, co-operative competition, the use of traders as agents, and trader information groups.

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