3. *Community, Market, and the State:* Role of Community

(Read Hayami in Eicher and Staatz ch.5)

Developing Countries

- **Market failure is more common and failure of private nonmarket institutions**

e.g.

  - **Learning, knowledge and information**
  - **Capital markets**
  - **Product markets**
- **Government failure**

Government Failure

- occurs when a government intervention causes a more inefficient allocation of goods and resources than would occur without intervention
- government intervention may make matters worse rather than better
- not a failure of the government to bring about a particular solution, but is a systemic problem which prevents an efficient government solution to a problem
- Failures cause by
  - **principal/agent problems** : asymmetric information when a principal hires an agent)
  - **Rent-seeking behaviour:** seeks to earn income by capturing economic rent through manipulation or exploitation due to the economic or political environment

1. Market Failure and Community Correction

Market Failure in Agrarian Villages

1.1 Production Externalities

1.2 Market failures in exchange due to high transaction costs

1.1 Production Externalities

Cause:

- **Ecological interdependence of biological process**

e.g.:

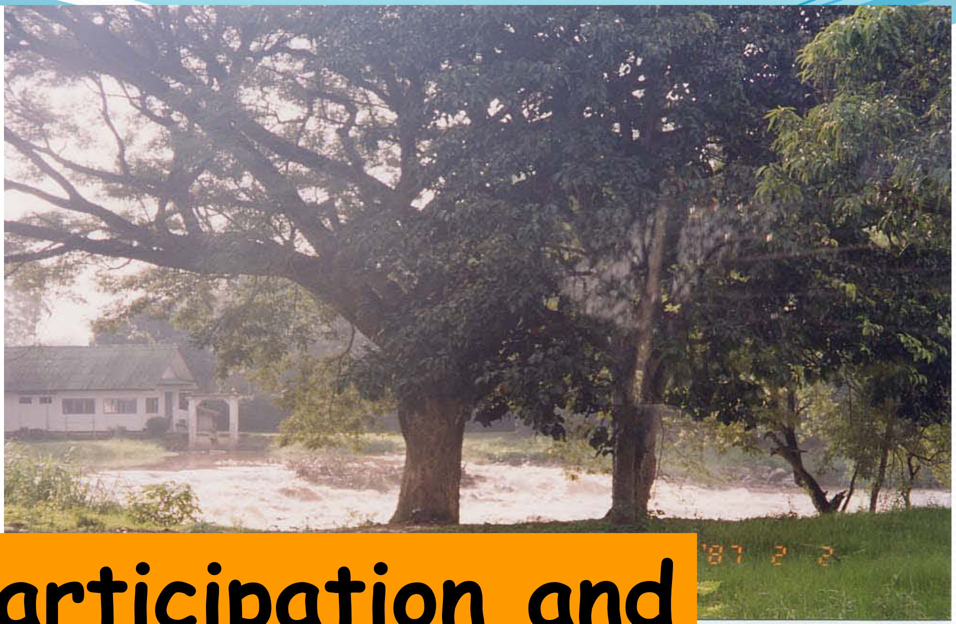
- **land clearing for cultivation in a mountain area →**
- **pesticide used upstream →**
- **only one organic farm →**
- **diversion of irrigation upstream →**

What the government has done is sometimes not appropriate to local conditions

Correction:

- **Coordination among farmers to reduce conflicts**

  e.g.
  - **Community irrigation system in the North (Meung Fai)**
  - **Group of organic farms in the Northeast**



People participation and the roles of community are needed

1.2 Market failure in Exchange

<u>Causes</u>

- **Marketable agricultural surplus of semisubsistent peasants is small in volume and variable in quality**

  (since inputs & production is not standardized mainly due to different eco-system)
- **Anonymous agents (e.g. no brand..)**

➔High transaction costs

- **Transaction costs**
  - **Information cost**
  - **Negotiation cost**
  - **Enforcement cost**

Corrections (outcomes):

formation of local informal institutions

- **To control quality of inputs**
  - **A patron-client relationship**
  - **Sharecropping tenancy**
- **For marketing of inputs and outputs**
  - **Agricultural cooperatives**
- **For both**
  - **Contract farming system**

2. Community Success

- **Success with**

  (1) clear objectives and rules

  (2) low transaction costs

  (3) Trust → cooperation , social capital
- **Rules: traditional customs, moral principles, newly established rules (institutional innovations)**
- **Why low transaction costs ?**
  - **Information cost**
  - **Negotiation cost**
  - **Enforcement cost**

3. Community Failure

- Traditions are slow to change
- Enforcement rules based on belief and social transaction
- Larger population
- Prisoner’s dilemma
- Monopoly (market power, dark influences) partly due to small no. of participants

The **prisoner's dilemma**

- is a fundamental problem in **game theory** that demonstrates why two people might not cooperate even if it is in both their best interests to do so.
- Merrill Flood and Melvin Dresher 1950,
- Albert W. Tucker formalized the game with prison sentence payoffs and gave it the "prisoner's dilemma" name

A classic example of the prisoner's dilemma

- Two suspects are arrested by the police. The police have insufficient evidence for a conviction, and, **having separated** the prisoners, visit each of them to offer the same deal.
  - If one testifies for the prosecution against the other (*defects*) and the other remains silent (*cooperates*), the defector goes free and the silent accomplice receives the full 10-year sentence.
  - If both remain silent, both prisoners are sentenced to only six months in jail for a minor charge.
  - If each betrays the other, each receives a five-year sentence.
- Each prisoner must choose to betray the other or to remain silent. Each one is assured that the other would not know about the betrayal before the end of the investigation.
- How should the prisoners act?
- What are assumptions behind the story?

Review

1. **What is "market failure"? Give some examples of market failure in agriculture.**
2. **According to Hayami, what is the role of "community" in agrarian economy?**

(additional reading:

Ammar Siamwalla, "Farmers and Middlemen: Aspects of Agricultural Marketing in Thailand" Economic Bulletin for Asia and Far East 29, 1978)