LARGE AGRICULTURAL INVESTMENTS AND INCLUSION OF SMALL FARMERS: LESSONS OF CASE STUDIES IN 7 COUNTRIES

Executive summary

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The scope of large scale land acquisitions in southern countries has brought back the debates on food security, land governance and agricultural development models. Various international institutions, recognizing the need for increased private investments in agriculture but also keen to minimize potential risks associated with large-scale agricultural plantations, are promoting business models that allow to both maximize opportunities for rural populations and minimize the risks (Cotula *et al*., 2009 ; Von Braun and Meinzen-Dick, 2009 ; Görgen *et al*., 2009 ; World Bank, 2010). Thus, a renewed interest has emerged in production patterns involving local farmers as landholders (contract farming) or shareholders (joint venture) (Vermeulen and Cotula, 2010).

In order to check and promote the positive synergies between private companies and rural households, an analysis of past and ongoing experiences of contract farming is required. It represents the main objective of this report.

The objectives of this study are to:

- describe the effects of contract farming schemes,
- characterize the factors limiting or promoting these various impacts,
- identify key findings to promote the emergence of positive synergies.

The study' considers a long-term time scale (10 to 50 years) and pays particular attention to changes in agricultural farming, production systems, access to markets and governance patterns of value chains. The study also analyzes how crops initially introduced thanks to contract farming schemes develop "off contract" and induce new value chain.

The study focuses on seven countries - Ivory Coast, Ghana, Burkina Faso, Kenya, South-Africa, Laos and Indonesia – and major commodities such as: oil palm, rubber tree, fruits and vegetables, cereals, cotton and sugar cane. It is organized into 4 sections: i) the contract schemes, ii) the effects of these schemes, iii) the factors determining the nature and intensity of these effects and iv) key findings to promote positive synergies. Case studies are briefly presented in the appendix.

Contract schemes studied vary according to the type of company and producer, the agricultural product, product market characteristics, the role of the State and of course, contracts between the companies and the farmers. Six major types of contracts analyzed in the case studies are presented. If all the contracts include clauses relating to the purchase of the crop, they differentiate according to: process and quality specifications, provisions of upfront inputs (seeds, fertilizers, pesticides, credits and technical advice), degree of labour supervision and number of technical tasks carried out by the company.

[1] This document is a summary of the study "Grands investissements agricoles et inclusion des petits producteurs: leçons d'expériences dans 7 pays du sud" by Perrine Burnod and Jean-Philippe Colin. The complete document (101 pp.) is available in French only at http://www.fao.org/docrep/017/aq004f/aq004f.pdf

Why do companies choose contract farming?

Setting up contract farming results from, first of all, a political willingness of the State to promote the agricultural sector and rural development (oil palm in Ivory Coast, Ghana and Indonesia; rubber tree in Ivory Coast; cotton in Burkina Faso; and sugar cane in South Africa). This setting up has benefited from funding from the State and/or donor agencies. Whether promoted by national policies or not, companies argued that this resort to contract farming is a means of:

- developing a production which was previously absent in farmers' production systems in order to diversify and ensure the quantity of their supplies (canned pineapple, rubber tree and oil palm in Ivory Coast);
- reducing supply costs, mostly through savings associated with the cost of labour and supervision (cotton in Burkina Faso, oil palm in Ghana, canned pineapple in Ivory Coast, vegetables in Kenya);
- overcoming constraints to access land in areas where the land is already cultivated (oil palm and rubber tree in Ivory Coast) or subject to land reforms (sugar cane in South Africa), or even further compensating local populations in exchange for the compulsory taking of their land (oil palm in Indonesia). Thus, companies opt for contract farming since they cannot extend their control on land;
- (quite recently) promoting more inclusive and equitable modes of production (vegetables in Kenya) and, for some companies, improving their socio-political image (fruits and sugar cane in South Africa).

Effects

Contracts for all?

The impacts in term of exclusion or inclusion of smallholders are quite different in various cases. The following features are observed according to the cases:

- inclusive dynamics for a majority of small farms in some cases (examples are the fruit value chains in South Africa, Kenya and Ivory Coast) ;
- dynamics initially including small or medium farms and involving later on larger farms developed by small and medium domestic urban investors (oil palm and rubber tree in Ivory Coast) ;
- processes including initially a wide range of producers but excluding at a second stage the smaller ones, unable to meet the production and contract economic requirements (oil palm in Indonesia).

Nevertheless, the analysis benefits from going beyond the single framework of the contract scheme. In many cases a phenomenon of participation and, in particular, of smallholders can also result from further dissemination and outside contracts of the contract crop within a contractual framework (pineapple, palm trees, and rubber tree in Ivory Coast; palm trees in Ghana).

Moreover, whereas the participation of migrants in the development process of a new crop is in certain cases commonly analyzed (Ivory Coast and Indonesia), that of women and young people (under 35) is less common.

Increasing incomes?

An increase in smallholders' incomes is observed in many cases, but not all, and is certainly not a 'systematic' impact. In some cases, this increase is only temporary or it only benefits the better-off farmers (oil palm in Indonesia).

The production, whether or not in contract farming schemes, can generate a permanent income throughout the year (oil palm, rubber tree; some fruit and vegetables), or it can be a source of delayed incomes for the time of retirement (oil palm, rubber tree in Ivory Coast). Alternatively (pineapple or cotton), some producers appreciate to obtain a substantial monetary income at once, which can fund investments.

Access to credit through the provision of inputs, even turnkey plantation, is a common feature of the majority of contract schemes. In some cases, the reliance on credit or its costs constitute a source of debt for vulnerable smallholders (oil palm in Indonesia). In other cases access to credit is a factor which has improved incomes (vegetables in Kenya) and the farms' investment capacities (mechanization for cotton in Burkina Faso).

What effects on the rural labour market?

The effects of contract farming, poorly documented particularly with respect to labour management within the family, are clearly visible on the local labour market. Job opportunities increase to meet the needs of the companies (plantations and processing units), as well as those of the contract farmers. These opportunities neither exclusively benefit nor are they seized by the local population. These jobs are often taken by migrants who have specifically come for them (oil palm in Indonesia) or who are already involved in the local labour market (oil palm and rubber tree in Ivory Coast). The pay rates are those of the local labour market and these jobs bring benefits to less-resourced households. However, working and pay conditions– notably in the companies' plantation or processing unit– are often not complying with national labour legislations (Indonesia, Laos and South Africa).

What effects on land rights and land markets?

The development of contract farming is a major alternative to large-scale land acquisitions so that local land rights are not jeopardized. Nevertheless, companies combining both contract farming and direct large-scale plantations have been involved in the expropriation of some local populations from customary lands. In some cases, this was through the allocation of non-cultivated land (considered as land reserves by local populations) to the company. In the best case scenario, these populations have received compensation in the form of official redistribution of a smaller part of the previously owned land (Indonesia, Ghana and Laos).

Moreover, case studies show that contract farming contributes sometimes directly or indirectly to the “commoditization” of land and the emergence of monetary land markets (emergence or multiplication of lease contracts, sharecropping and land sales; examples in Ghana or Ivory Coast). Migrants can get involved in contract farming due to diverse arrangements with local landowners to enjoy land use rights. Contract farming can be the source of intrafamily tensions, as contracts and cash crops controlled by household heads may encroach upon lands previously allocated to the family members.

A specialization of production systems detrimental for household food security?

In case studies, contract farming is not harmful to the households’ food security. Farmers generally develop the contract crop in a strategy of crop systems diversification but not in a strategy of specialization. In many cases, famers did not develop the contract crop in substitution for food crops but they cultivated it on land previously allocated to another cash crop (Ivory Coast, Ghana, and South Africa) or in forests (Indonesia and Burkina Faso) – which may induce problems of access to firewood and biodiversity maintenance. Nevertheless, due to access to inputs, farmers can improve food crop production (cotton in Burkina Faso). Finally, through the incomes from the contract crop, farmers can buy foodstuffs in local markets (Ivory Coast).

Technical innovations?

As a result of contract farming, smallholders have mastered new crops and new agricultural practices largely based on the achievements of agricultural research. The learning process can spread the benefit of other crop systems (labour in Burkina Faso and Ivory Coast for food crops) and beyond contract holders (pineapple, rubber tree and oil palm in Ivory Coast, palm in Ghana). It has also been facilitated by innovations from farmers who adapted the practices recommended by agribusinesses to cut production costs (companion crops, reduction in the quantities of fertilizers, absence of graft wood for rubber tree, etc..).

An intensification of production systems?

The case studies showed more intensive production in terms of labour (although not in all cases), inputs (broader access to improved varieties, fertilizers and chemical products) and in expertise. The only capital-based intensification results from perennial plantations of new varieties and, in some rare cases, investing in mechanized equipment.

Smallholders' dependence or room for manoeuvre?

Contract farming avoids commercial risks for producers and sometimes provides them with an outlet to international markets (fruits and vegetables value chains in South Africa and Kenya). But in most of the case studies, a monopsony situation, lack of transparency and information on prices and (often) close relations between the company and the government severely undermine smallholders' negotiating power (oil palm in Indonesia, palm and rubber tree in Ivory Coast). Nevertheless, the creation of agribusiness or transformation plants can, over time, open new commercial alternatives for the producers (Ivory Coast, Ghana). More marketing opportunities does however often weaken the contractual relationships. As a result of the diversification of buyers, smallholders have increased opportunities to be paid in cash and evade their contractual obligation (most notably, to reimburse their credit). It does not systematically confer a better negotiating power to smallholders but puts them in tense relations with the contracting company... and jeopardizes the sustainability of the contractual scheme.

Effects on farmers' organisations and representation of the interests of producers

In the majority of cases studied, the creation of farmers' organisations was the action of the State or of companies. These organisations, when they managed to remain intact, were not effective cooperatives or associations (oil palm in Indonesia, canned and exported pineapple in Ivory Coast). They seldom defended the smallholders' interests. Since the late 1990s, local organisations are renewed from support by NGOs or development agencies. Their objectives are to increase their bargaining power with government and investors, reduce transaction costs related to contracts and improve information sharing among farmers and stakeholders (local and national independent organizations in Indonesia, cooperatives and joint-trade organization in the oil palm sector in Ivory Coast, National union of cotton producers in Burkina Faso).

Major lessons learnt

Adoption and dissemination of contracts and, more broadly, crops

Long term analyses have emphasized that contract farming first played a role in innovation and diversification of crops, and then in the impetus to a new value chain. Farmers develop crops cultivated independently of any contract scheme; new buyers and brokers position themselves on the market; new rural industries or agro-processing plants are created, thus generating the development of a whole value chain (in Ivory Coast, pineapple, oil palm, rubber tree; and in Ghana, oil palm).

The case studies identified five key factors that promote the adoption, success and dissemination of crops (on or off-contract):

- the quality of the support activities by the agribusiness companies: regular payments, credits' terms and conditions, the kind of inputs provided as well as the transparency and clarity of contractual commitments;
- the evolution, in the long term, of the producers' net earnings;
- land availability within the farm or locally, possibly through local land markets;
- the characteristics of the crops entailing various payment modes (number of months and/or years to get the first harvest, steadiness in harvests, etc.) and the level of investment in terms of capital, labour and expertise;
- information and service sharing among producers, within groups or not, intended to facilitate expertise transfers and reduce production costs.

Exclusion or inclusion of smallholders

Diachronic analysis emphasises that the phenomena of selection, inclusion or exclusion of smallholders need to be broken down.

A first selection can occur right from the implementation phase of the contract scheme. Until the 1990s, national agricultural policies, clearly directed upstream by the donors, determined the profile of farmers included in contract schemes. These policies have thus affected a wide range of farmers including smallholders which actually make up the large majority of the farms in the rural sector. Since the 1990s, the role of the State remains important to define incentives but is less directly important. Companies develop contract farming to delegate labour intensive crops (horticultural products in Kenya) or to guarantee them a progressive image (South African enterprises).

A second selection of smallholders might step in during the development of the contract scheme. In the cases studied, the process of exclusion of smallholders of the contractual organization seemed more to be the result from entrance or exit of some smallholders rather than an explicit policy of the companies (in fact, all studied contract crops were not subject to high quality standards, therefore the role of these standards in the exclusion of certain categories of smallholders was not analysed). On the one hand, farmers leave the contract scheme when they are unable to reimburse their credit to the company (oil palm in Indonesia) - some can also leave the scheme when they have a more profitable alternative. On the other hand, farmers, often urban people retired and/or executives attracted by the development of a remunerative agricultural activity, get involved in the contract schemes (oil palm in Ivory Coast).

A third phenomenon corresponds to dissemination of the crop outside the contract scheme. It might bring benefits to various categories of farmers, including small ones (oil palm and rubber tree in Ivory Coast, palm in Indonesia and Ghana).

Improvement in smallholders’ incomes and investment capacities

In case studies, improvement of smallholders’ income depends on international rates, the efficiency of the company, the type of contract and, in a more tenuous and recent manner, the smallholders’ capacity to negotiate the terms and conditions of these contracts. This concerns in particular: the purchase price, based on national and international rates and especially on the company and State’s policies; the level of billing services provided by the company and production standards.

Land management and equitable access to land

The implementation and development of agribusinesses and contract schemes have direct and indirect impacts on local land distribution. Some key factors influencing these effects are the following: national policies related to investments and land tenure; the organization of production (large farm or contract schemes, including joint ventures); and the type and activity of land markets. Case studies particularly underline that rental markets (sharecropping, lease) allow access to land and contracts for a wide range of farmers (including migrants) without changing the distribution of land property. *A contrario*, the land sales markets mostly benefit the better-off and relatively wealthy individuals (executives, traders, government officials, local and national elected representatives). They gradually transform land distribution (usually towards more concentration of land ownership), notably in peri-urban areas (oil palm in Indonesia, Ghana and Ivory Coast; rubber tree in Ivory Coast).

Innovation

The major innovation, promoted by the contract scheme but developing sometimes outside it, is the adoption and dissemination of new crops and farming practices. It is promoted by: the achievements of research institutions and their support; the provision of inputs, credits and technical support provided by agribusiness and/or the State agricultural services; informal circulation of information and most importantly the progressive development of a new value chain.

Governance of the value chain

The transition from a simple contract, imposed by the agro industry, to a representation of smallholders within committees of enterprises and an active participation in the negotiations of the contract terms, seems to result from: a national political willingness, a policy of transparency from the part of the agribusiness, the existence of effective smallholders’ groups, and in quite a number of cases, the donors’ support and/or NGOs’ support for the establishment of arenas of discussion.

Ways forward for sustainable and equitable contract schemes

The role of the State

The government plays a major role in setting up a legal and economic environment conducive to contract farming and, a particularly major role in promoting and providing political support to contract schemes, through:

- the recognition and respect of local populations' land rights and consequently, by limiting abusive land appropriation. The main thing is that land rights are secured, whether they are property rights or use rights, so that agribusiness and smallholders (owners and tenant farmers) can have the guarantee of return on investments. The security mechanisms need not necessarily be made formal by a land title or certificate, they can be local and founded on social recognition;
- the development of devices to prevent unfair contracts and securing the contractual commitments;
- the strengthening of smallholders' organizations and the creation of an arena of negotiation and mechanisms of dispute settlement;
- the dissemination of information on "contract good practices" and on prices.

Role of smallholders' organizations

Farmers' organizations (FO) can reduce the transaction costs of dealing with a large number of farmers and, more generally, the cost of implementing the contractual scheme. Above all, farmers' organizations can present a cohesive position, address asymmetries in bargaining power with investors and government and then, design more collaborative and equitable schemes.

Nevertheless, famers' organizations can encounter various difficulties. First, the company may refuse to deal with organizations in order to avoid their cohesive position and strong bargaining power or, on the contrary, their internal dissensions. It may also refuse to deal with organization to implement better individual traceability system. Secondly, farmers' organisations may encounter collective action problems, lead to the exclusion of some smallholders or be opportunistically used by elite members.

Since the 2000s, smallholders' organizations have been empowered thanks to:

- sustained investments in capacity building;
- a shift in their functions from furnishing technical services to protecting smallholders rights and interests;
- strong and complementary linkages between local farmers' organizations and national ones;
- national or local arenas for negotiation, often created and supported by the government, civil society and development agencies.

Role of private enterprise

Agribusinesses can promote sustainable and inclusive contract schemes through:

- recognizing and respecting local land rights regardless of the national land policy. Contract farming limits the social and political risks associated with acquiring land and running large-scale plantations. Agribusinesses can enjoy better political acceptability and avoid suspicion at the local level by stating clearly the terms and conditions of the contract;
- supporting smallholders, within or outside a public-private partnership, in relation to access to inputs (from seeds to credit) and, particularly, access to expertise and training so that a wide range of smallholders can conform to new standards of production;
- setting up key elements encouraging smallholders to respect their contract: diverse and concrete services, and remuneration arrangements allowing smallholders to overcome their financial constraints;
- transparent management and effective communication on terms and conditions determining the purchase prices and the costs charged to the producers. In certain cases analysed in the report, the quality of the relationship between agribusiness and smallholders proves to be more important than the method of formalising the relationship (i.e. type of written contract).

Role of development agencies, research institutions and groups supporting smallholders

Development agencies can play a decisive role in supporting:

- national agricultural, territorial development and land reform policies,
- arenas of negotiation such as multi-stakeholder platforms for governance of agricultural value chains;
- organisations protecting the interest of smallholders such as intersectoral organizations or national platform of farmers' organisations;
- provision of grants and bank guarantees for stakeholders of collaborative business models;
- dissemination of information and lessons on successful contractual schemes and joint-ventures.

Other support structures can provide essential functions in order to carry out capacity transfer:

- agricultural research institutions can improve agricultural practices adapted to households' environment and constraints;
- organizations providing learning and capacity building for smallholders (legal issue, market analysis, team management, etc);
- law organisation furnishing legal advice and assistance.

Challenges

National policies, donor agencies and/or foundations' incentives generally encourage the implementation of contract schemes. Without these incentives, agribusiness companies are reluctant to initiate contract farming schemes with smallholders due to high transaction costs. A challenge is therefore to provide appropriate 'keys' and ways for private entrepreneurs to grasp the advantages of contract farming (profitability of contract farming against large-scale farming being poorly documented) and to provide them with technical and institutional support rather than financial support.

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List of case studies

Country	Crop	Period
Ivory Coast	Pineapple	1955-2010
	Rubber tree	1967-2008
	Oil palm	1963-2010
Ghana	Oil palm	1975-2011
Indonesia	Oil palm	1980-2005
South-Africa	Fruit, sugar cane	1990-2010
Kenya	Vegetables and flowers	1980-2000
Burkina Faso	Cotton	1970- 2005
Laos	Rubber tree, corn, cassava, sugar cane,	2000- 2010

The study was coordinated by Perrine Burnod (CIRAD) and Jean-Philippe Colin (IRD). The titles of specific case studies, and their authors, are listed in the French version of the Executive Summary.