Making contract farming work with cooperatives

Producer organisations and poverty reduction

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The World Development Report 2008 is optimistic that contract farming can help reduce poverty. For it to succeed, producer organisations must play a big role.

Contract farming is a system where a private sector firm provides farmers with inputs ? such as credit, fertiliser and seed ? in exchange for exclusive purchasing rights for the resulting crop. According to the WDR 2008, contract farming enables smallholder farmers to participate in new high-value product markets and improves quality standards, thus increasing and stabilising farmers? incomes. Because most farms in developing countries are smaller than two hectares, integrating smallholder farmers into global value chains is an important step towards reducing poverty. But, there are also risks associated with contract farming. Such risks can be reduced if a greater focus is put on strengthening market-oriented producer organisations and creating mechanisms for resolving disputes between farmers and firms.

Opportunities for farmers and firms

There are good reasons for expanding contract farming. Following the collapse of international commodity agreements and the liberalisation of national markets, agricultural value chains have become increasingly buyer-driven and vertically integrated. In such an environment, contract farming offers the best of both small- and large-farm production systems. Smallholder farmers are often the most efficient agricultural producers and they have advantages over large farms in terms of reduced labour-related transaction costs (especially supervising and motivating workers). However, smallholders often suffer from capital constraints, and they lack capacity to adopt technological innovations. Contract farming can overcome these difficulties, and can deliver benefits typically associated with large-farm production systems, including increased output with reduced input costs. Moreover, firms have a comparative advantage in market and technical knowledge, as well as in product traceability and quality.

From a poverty-reduction perspective, contracting smallholder farmers can yield large dividends: small farms are generally owned and operated by the poor, often use locally hired labour and usually spend their incomes on local products and services. And contract farming offers clear opportunities for smallholders. It gives them access to a reliable market, it provides guaranteed and fixed pricing structures, and most important, it provides access to credit, inputs, and production services. In broader terms, it can stimulate the transfer of technology and skills, and can help farmers comply with vital sanitary and phytosanitary standards.

There are also clear benefits for firms. Contract farming helps improve supply quantity and quality, and transfers any production risks onto farmers. In this respect, contract farming can increase profits from, and improve governance of, the value chain. And, especially where access to land is highly politicised, it can overcome land constraints. For example, firms may find it hard to obtain land, or may run the risk of expropriation if they own it.

The risks of contract farming

Although the arguments in favour of contract farming are convincing, there are also five key risks for smallholder producers. Contract farming can contribute to a loss of autonomy and control over farm enterprises. Smallholders also face substantial production risks if the technology available is inadequate or if the firm?s price forecasts are inaccurate. Third, the firm?s exclusive purchase rights can depress producer prices, or lead to late and partial payments (increased indebtedness is not uncommon). Fourth, contracts may be verbal or, if written, are not always in clear language (and conditions can be manipulated). Last, the vital gender dimension to smallholder farming often means that the intra-household distribution of labour/income is often altered to the detriment of women?s interests.

There are also risks for firms. Smallholders often seek to profit from the inputs and produce by side marketing. For example, they may sell fertiliser for cash, or sell the produce post-harvest (to gain faster access to capital, to seek higher prices, or just to avoid repaying the firm). The limited literacy and education of some small farmers may also increase risks for the firms, and a widely dispersed smallholder population certainly increases transaction costs.

The role of producer organisations

The WDR places great emphasis on the role of producer organisations in ensuring the stability and longevity of contract farming arrangements and in delivering a fair distribution of profits. It argues that institutional innovation, in the form of recent producer organisations, is essential for increasing win-win outcomes from contract farming. From a farmer?s perspective, producer organisations can help balance the power between firms and farms: collective bargaining, and the creation of relationships with rural credit and transport providers, can help reduce the risks farmers face. Moreover, producer organisations provide a forum where farmers can express their dissatisfaction over prices, timing, and increase the likelihood that a firm will recognise its social and environmental responsibilities.

From a firm?s perspective, producer organisations reduce the transaction costs per unit and resolve information and communication blockages. They are also important for fostering good relations between the farmer and the firm, as well as providing peer-embedded incentives for members to repay loans.

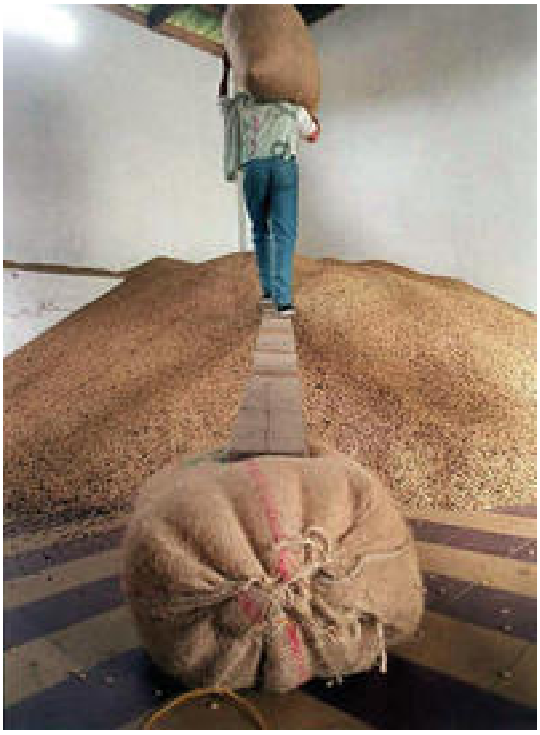
However, producer organisations are not necessarily a guarantee of successful contract farming. Many producer organisations collapse. Moreover, if problems with contract farming arise, firms can easily switch to engaging large-scale agricultural units.

Although the WDR recognises the limitations of many producer organisations ? for example, they frequently lack management capacity, they sometimes struggle to achieve coherence among a diverse membership, and are subject to elite capture ? there is a danger of placing too many expectations on these often incipient rural institutions. The WDR argues, for example, that the role of producer organisations should extend beyond improving the terms of engagement with contracting companies (or wider input, output and transport markets). In addition, they should become stakeholders in agricultural policy forums, support technological adoption, direct agronomic research, and manage communal natural resources.

The WDR?s policy response is for governments and development partners to encourage a political climate that supports the right to organise, to provide training, and attempt to empower weaker members within producer organisations (perhaps by harnessing the competences of specialist NGOs). Such policy goals are certainly admirable. However, in promoting successful marriages between contract farming and producer organisations, it is also important to focus on two key issues: strengthening market-oriented producer organisations and mechanisms for resolving disputes between farmers and firms.

Market-oriented producer organisations

The WDR distinguishes several types of producer organisation (PO) according to their function ? commodity-specific organisations, advocacy organisations and multipurpose organisations. But these may not be the best approaches to offering support to farmers for engaging with contracting firms. Focusing on market-oriented POs that provide benefits only to members is more likely to lead to successful contract farming arrangements than community-oriented participatory POs, which focus on providing public goods to an entire community. In this respect, a PO needs to be very clear about the goal it is working toward: increasing and stabilising smallholder incomes, or providing a platform for participatory governance and empowerment.



One example of a market-oriented PO is the National Smallholder Farmer Organisation of Malawi (NASFAM). Launched in 1997 with support from the US Agency for International Development (USAID), NASFAM has become the ?voice of the smallholder? in policy circles in Malawi?s capital, Lilongwe. Originally set up to promote smallholder production of burley tobacco (which had previously been reserved exclusively for estates), NASFAM has encouraged diversification by promoting commercial production of a range of crops, including coffee, chillies, rice, soya and cotton.

NASFAM is very much a smallholder-focused organisation. With over 100,000 members, most of whom farm less than a hectare of land, NASFAM has developed a network of smallholder-owned business organisations. The structure of these organisations has been one key to their success. Individual farming clubs, with between 12 and 20 members, are joined together into local group action committees, which are combined to form local associations. These in turn are grouped into a national body. The members of this democratic bottom-up organisation have a sense of ownership and elect board members annually in a highly transparent process. However, the main reason for NASFAM?s success has been its ability to develop the commercial capacity of its members and to deliver programmes that enhance their productivity. For example, NASFAM facilitates the provision of credit to smallholder associations (from a large number of providers), and provides extension and training through devolved field officers. It also uses economies of scale to reduce transportation costs and explores overseas markets for its members? produce.

Three further factors have been key to NASFAM?s success: it has remained apolitical; has received sustained donor support (especially in its early stages); and has created strong structures which divide its commercial, development and training functions. For example, the smallholder associations jointly own a not-for-profit company, the NASFAM Development Corporation (NASDEC), which provides access to commercial opportunities and development services. NASDEC in turn owns two subsidiaries. The first ? NASFAM Commercial (NASCOM) ? comprises the revenue-generating private sector business and marketing services. The second subsidiary - the NASFAM Centre for Development Support (NASCENT) ? provides development services that straddle the public-private divide: education and training, policy advocacy, and outreach work which covers HIV/AIDS, gender and other vital issues. This (simplified) structure has allowed donors to target their support to specific activities. It has also allowed the organisation to employ and utilise individuals who have particular (private sector, or development-based) skills.

Dispute resolution mechanisms

In view of the considerable risks faced by farms and firms, it is essential that state and non-state agencies offer accessible, transparent and legally binding mechanisms for resolving disputes between firms and producer organisations.

One example comes from smallholder sugarcane outgrowers in Morogoro, Tanzania. Following economic liberalisation in the early 1990, and the privatisation of the sugar mill, sugarcane outgrowers formed a number of producer organisations, and an umbrella body ? the Tanzanian Sugarcane Growers Association (TASGA). Dependent on one privately owned mill to market their produce, and struggling to realise a profit, for a number of years growers were in conflict with the mill owners. The reasons are familiar ? low prices, perceived unfairness in the grading of produce, and delayed payments ? and the mistrust led to a number of protests (including blockading the mill until payments were made).

Since 2005/06 such disputes have been rare. Instead, and based on the Sugar Act of 2001, the involved parties (including the national sugar board) implemented a series of forums, consultations and stakeholder meetings. Moreover, they signed legally binding contracts which have acted as a release valve for the mistrust and resentment. Specific measures have included an independent audit of the all-important weighbridge every six months, the provision of six Ministry of Agriculture extension agents, an extra extension manager employed by the mill, and an agreement that payments will always be paid within two months. Whilst resolving such conflict takes time and energy, the benefits are clear: outgrowers? incomes are up (with benefits for themselves and the wider community), and the mill can operate more efficiently and effectively.

The recently announced Cooperative Facility for Africa (COOPAfrica), launched by the International Labour Organization (ILO) and funded by the Department for International Development (DfID), offers a good opportunity for creating such dispute resolution mechanisms. COOPAfrica aims to develop partnerships between POs and international cooperative movements, and use ?challenge funds? to support institutions offering training and services to POs. In doing so, COOPAfrica could foster mechanisms to ensure the longevity of contract farming operations, and thus integrate smallholders into (global) value chains.

Marrying contract farming and producer organisations offers substantial potential for poverty reduction. For the vision of the WDR 2008 to have the greatest chance of being realised, there is a need to be selective about the types of producer organisations that are supported, and the provision of spaces where disagreements and conflicts can be easily resolved.

Much of this article has been previously published as: Prowse, M. (2007) Making Contract Farming Work with Cooperatives, ODI Opinion 87, ODI, London, UK.

Further reading

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Links

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