Large-scale agricultural investments and inclusion of smallholder farmers: lessons of experiences in 7 southern countries

February 2012

Study coordinated by Perrine Burnod (CIRAD) and Jean-Philippe Colin (IRD)

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EXECUTIVE SUMMARY

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Study coordinated by
Perrine Burnod (CIRAD) and Jean-Philippe Colin (IRD)

Authors of case studies :

Ward Anseew (CIRAD)

Emmanuelle Cheyns (CIRAD)

Johanna Clerc

Jean-Philippe Colin (IRD)

Guy Faure (CIRAD)

Sandrine Freguin-Gresh (CIRAD)

François Ruf (CIRAD)

Isabelle Vagneron (CIRAD)

Gaspard Vognan (INERA)

To quote it :
Burnod, P., Colin, J.-Ph., Ruf, F., Freguin-Gresh, S., Clerc, J., Faure, G., Vagneron, I., Anseeuw, W., Cheyns, E., Vognan, G. 2012. **Large-scale agricultural investments and inclusion of smallholder farmers: lessons of experiences in 7 southern countries,** executive summary, Cirad/FAO, Montpellier/Rome.

The synthesis and the set of studies developed are available at
http://www.cirad.fr/publications-ressources/edition/etudes-et-documents

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Context of the study and acknowledgements

This work has been funded by FAO (Food and Agriculture Organization of the United Nations). The views expressed do not necessarily reflect those of this institution.

The authors would like to thank the following people in particular for their contributions throughout this study and on earlier drafts of the report: Paul Mathieu, Pascal Liu, Garry Smith, Clara Park, Nora Ourabah Haddad, Guy Evers.

The authors

Coordinators and authors of the synthesis: Perrine Burnod and Jean-Philippe Colin.

Authors of the case studies: Ward Anseeuw, Emmanuelle Cheyns, Johanna Clerc, Jean-Philippe Colin, François Ruf, Guy Faure, Sandrine Freguin-Gresh, Isabelle Vagneron and Gilles Vognan.

Researchers who have contributed to drawing up and monitoring the study: Sylvaine Lemeilleur, Estelle Bienabe, Pierre-Marie Bosc.

Executive summary

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

In order to check and promote the existence of effectively positive synergies between private companies and rural households, a thorough understanding of past and ongoing experiences of contract farming is required. It represents the central point of the present report.

The objectives of the study are then to:

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

Its original aspects are to develop a long-term analysis (10 to 50 years) and to pay 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. .

Drawing on a literature review and authors ‘research reports, the study focuses on seven countries - Ivory Coast, Ghana, Burkina Faso, Kenya, South-Africa, Laos and Indonesia – and some major productions (oil palm, rubber tree, fruits and vegetables, cereals, cotton, sugar cane). It is organized into 4 sections respectively representing: 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 vary according to types of companies and producers, agricultural productions, products market, role of the State and, of course, contracts linking the enterprise and 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.

Why do companies choose contract farming?

Setting up contract farming results first of all from 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, sugar cane in South Africa). Hence, this setting up has benefited from funding from the State and /or donors agencies. Promoted or not by national policies, companies argued that this resort to contract farming is a means of:

- developing a production up to then absent in farmers' production systems in order to diversify and ensure the quantity of their supplies (canned pineapple, rubber and palm oil tree in Ivory Coast),
- reducing supply costs notably thanks to an economy on labour and supervision costs (cotton in Burkina Faso, oil palm in Ghana, canned pine apple in Ivory Coast, vegetables in Kenya),
- avoiding direct takings of land in areas where the land is already mostly occupied and 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 land hold ;
- 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?

Exclusion or inclusion of smallholders strongly varies. What appears according to the cases are:

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

Nevertheless, the analysis benefits from going beyond the only framework of the contract scheme. In many cases, a phenomenon of inclusion and, in particular, of inclusion of smallholders can also result from the dissemination outside contracts of the contract crop (pine apple, palm, and rubber tree in Ivory Coast; palm in Ghana).

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

Increase in incomes?

The increase in smallholders' incomes is noted but far from being systematic. It can be only temporary or bring benefit only to the well-off holders (oil palm in Indonesia). Access to credit thanks to upfront inputs, even turnkey plantation, is a common point for the majority

of contract schemes. In some cases, access to credit is too high or too expensive and constitutes a source of debt for the most fragile smallholders (oil palm in Indonesia). In other ones, access to credit is a success factor, notably in improving 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 on labour management within the family, appear clearly on the local labour market. Jobs opportunities increase to meet the needs of the companies (plantation and processing unit), as well as those of the contract farmers. These opportunities do not benefit exclusively to the local populations or are not even seized by these latter. These jobs are taken by migrants already involved in the local labour market (palm and rubber tree in Ivory Coast) or who have specially come to get them (oil palm in Indonesia). The pay rates are the ones of the local labour market and these employments bring benefits to less-resourced households. But the working and pay conditions– notably in the company's plantation or processing unit– are often not in compliance with the legislations in force in the countries (Indonesia, Laos and South Africa).

What effects on land rights and markets?

The development of contract farming is a major alternative to large-scale land acquisitions so that the local land rights are not jeopardized. Nevertheless, the development of companies, doing both contract farming and large-scale plantations, involved in the past expropriations (possibly on non-cultivated land, considered as land reserves by local populations). In the best of possible cases, these populations have received compensation in the form of redistribution of part of their land (Indonesia, Ghana and Laos).

Moreover, case studies show that contract farming directly or indirectly contributes sometimes to fostering land markets (emergence or multiplication of lease contracts and sharecropping as well as land sales, see examples in Ghana or Ivory Coast). Unexpectedly, migrants can get involved in contract farming thanks to diverse arrangements with local landowners to enjoy land use rights. Production contract can be the source of intrafamily tensions, as contracts and cash crops controlled by household head may encroach upon lands previously allocated to the family members.

A prejudicial specialization of production for households' 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 it in substitution for food crops but they cultivated it on land previously allocated to another cash crop (Ivory Coast, Ghana, and South Africa) or on wooded land (Indonesia and Burkina Faso – which may induce problems of access to firewood and biodiversity maintenance). Even, thanks to access to inputs, farmers can improve food crop production (cotton in Burkina Faso). Lastly, thanks to incomes from the contract crop, they can buy if necessary foodstuff on local markets (Ivory Coast).

Technical innovations?

Thanks to contract farming, smallholders have mastered new crops and new agricultural practices, largely founded on the achievement of agronomic research. The learning process

can be disseminated for 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 agribusiness to cut the production costs (companion crops, reduction in the quantities of fertilizers, absence of graft wood, ect.).

An intensification of production systems?

The cases retained actually show an intensification in terms of labour (but not on a systematic basis), inputs (wide access to improved varieties, fertilizers and chemical products) and, in expertise. The only capital-based intensifications correspond to carrying perennial plantations from selected varieties and, in some rare cases, investing in mechanization material.

Holders' dependence or room for manoeuvre?

Contract farming cancels commercial risks for holders and sometimes provides them with an outlet on international markets (fruits and vegetables value chains in South Africa and Kenya). But, in most of the study cases, monopsony situation, lack of transparency and information on prices and, often, the close relations linking the company and the government severely undermine smallholders' negotiating power (oil palm in Indonesia, palm and rubber tree in Ivory Coast). Nevertheless, over time, the setting up of agribusiness or craft enterprises can open new commercial alternative for the producers (Ivory Coast, Ghana). Thanks to the diversification of buyers, smallholders have an opportunity of being paid in cash and evading their contract obligation (notably to reimburse their credit). It does not systematically confer a better negotiating power to smallholders but gets them in tense relations with the contracting company... and jeopardizes the sustainability of the contractual scheme.

Effects on structuring farmers' organisations?

In the majority of the cases under study, the creation of smallholders' grouping was the action of the State or companies. The groupings, when they managed to hold in position, were not effective cooperatives or associations (oil palm in Indonesia, canned then export pineapple in Ivory Coast). They seldom defended the smallholders' interests. Since late 1990s, groupings are renewed notably thanks to NGO or development agencies' support. Their objectives are to increase the smallholders' negotiating power, reduce the transaction costs relating to contracts and improve information sharing among the parties (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

Adoption and dissemination of contracts and crops.

A long term analysis emphasized that contract farming plays a role first in crops innovation and diversification and, then, in the impetus to a new value chain. Farmers develop the crop 'off-contract', new buyers and brokers position themselves on the market, industries are set

up, thus generating the development of a whole value chain (in Ivory Coast, pineapple, oil palm, rubber tree; in Ghana, oil palm).

In the case studies, four major factors can promote the adoption and dissemination of the crop (on or off-contract):

- the quality of the plan set up by agribusiness; the quality concerning the steadiness of payments, the credit terms and conditions, the kind of inputs provided as well as the transparency on the contract commitments ;
- the evolution, in the long term, of the producers' net earnings ;
- land availability within the farm or at the local level, possibly via local land markets ;
- the characteristics of the crop entailing various payment modes (number of months and/or years to get the first harvest, steadiness in harvests, etc.) and a differential level of investment in terms of capital, labour and expertise,
- information and service sharing among landholders, within groupings or not, intended to facilitate expertise transfers and reduce production costs.

Exclusion or inclusion of smallholders.

Diachronic analysis emphasises that the phenomena of selection, exclusion 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, agricultural national policies, clearly directed upstream by the donors, determine the profile of farmers included in contract schemes. These policies have thus affected a wide range of farmers, including small structures which actually make up the large majority of the farms in the rural sector. Since the 1990s, the role of the State has been remaining incentive but is less deciding. 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. Exclusion from the contract organization seem to result from entrance or exit of some smallholders rather than an explicit policy of enterprises (in fact, all studied contract crops were not subject to high quality standards, hence, 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 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 a 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 company efficiency, the type of contract and, in a tighter and recent way, the smallholders' capacity to negotiate the terms and conditions of these contracts. This covers in particular:

the purchase price, depending on national and international rates and especially on the company and State's policies; the invoicing level for services provided by the enterprise and the production standards.

Land management and equity access to land.

The implementation and development of agribusinesses and contract schemes play directly and indirectly on the local land right distribution. Investment and land national policies, the organization of production (large farm or contract schemes, including joint ventures) and the activity of land markets modulate these effects. Case studies particularly underline that the rental market (sharecropping, lease) allows land and contract access to a wide range of farmers (including migrants) without changing the distribution of land tenure. *A contrario*, the purchase-sale market, to the benefit of relatively better-resourced persons (executives, traders, government officials, and elected representatives), changes progressively land distribution, notably in peri-urban environment (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 achievement 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 especially 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 agribusiness' policy of transparency, the existence of smallholders effective grouping, and in quite a lot of cases, the donors' support and/or NGOs' support to the institution of arena of discussions.

TRACKS FOR VIABLE AND EQUITABLE CONTRACT SCHEMES

The role of the State.

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

- the recognition and respect of local population land rights and consequently, by limitation of 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 implementation of contractual enforcement devices ;

- a strengthening of the smallholders' organizations and the creation of arena of negotiation and mechanisms of dispute settlement;
- a dissemination of information on "contract good practices" and on prices.

Role of smallholders' organizations.

The farmers' organizations can ease the setting up of more efficient contract farming schemes by strongly reducing the transaction costs of dealing with large numbers of farmers. Above all, they can push for the improvement of more equitable schemes by improving the smallholders' negotiation and lobbying capacities.

Nevertheless, many problems hinder these organizations. On the one hand, the enterprise can refuse to deal with organizations to avoid this balance of power, not to have to address the organizations internal problems, or to work with individuals for a better traceability system. On the other hand, running organizations can be burdened with problems of collective action, lead to the exclusion of certain categories of smallholders or be hijacked by the elite for their own ends. The effective activity and impact of smallholders' organizations seem to have improved since the 2000s thanks to:

- training and institutional and organizational support;
- a structuring intended to protect the smallholders' interest and not take on responsibility for production and marketing;
- a structuring aligning with a local representation and, thanks to network organization, a national representation;
- the effective existence of arena of negotiation, and nearly systematically, a support to their running by the government, civil society and development agencies.

Role of private enterprise.

Agribusinesses can promote productive contract schemes and very likely viable and more equitable ones through:

- whatever the national land policy, recognizing and respecting of local land rights (contract farming schemes including joint venture). Contract farming limits the social and political risks associated with acquiring land and running large-scale plantation. 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, especially, access to expertise and training so that a wide range of smallholders can conform to new standards of production ;
- setting up key ingredients encouraging smallholders to respect their contract : concrete services and terms and conditions for the pay allowing the smallholders to overcome the constraints pressing on their farm (notably treasury constraints) and not exclusively the ones pressing on the enterprise ;
- a transparent management and an effective communication on the costs charged to contract smallholders and on terms and conditions determining the purchase prices. In certain cases analysed in the report, the quality of the relation between agribusiness and smallholders proves to be more important than the formalisation mode for relation (i.e. type of written contract).

Role of development agencies, research institutions and groups supporting smallholders.

Development agencies can play determining part:

- in the support to funding national policies on agricultural and territorial development,
- in the introduction of arena of negotiation and structures protecting the interest of smallholders (*interprofession*, multi-players platform for the value chains management, associations of smallholders representation) ;
- in setting up public-private partnership via a support to smallholders enterprises and organizations.

Beyond the crucial role of the State, accompanying structures can carry out essential functions:

- institutions of agricultural research to improve agricultural practices adapted to the constraints of households and their environment,
- organizations capable of providing learning and capacity building for smallholders in terms of management as well as institutional coordination. Public structures or non-governmental organizations can provide these functions but the issue is to carry out the capacity transfer and recording it as a long-term support.

Challenges.

The introduction of contract schemes often results from government's incentive national policies and donor agencies and foundations' technical and financial support. Agribusiness representative can actually be reluctant to initiate contract farming scheme with smallholders due to high transactions costs. A challenge is therefore to provide appropriate keys to private entrepreneurs to grasp the advantages of contract farming (while being aware that the issue of profitability of contract farming against large-scale farming is very little documented notably on account of a problem assessing transaction costs) and to provide them technical and institutional support rather than financial support.

List of cases under study

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,	Années 2000

Agricultural Research for Development

42, rue Scheffer, 75116 Paris - France
Tél : +33 1 53 70 20 00
Fax : +33 1 53 70 20 34
www.cirad.fr

Food and Agriculture Organization of the United Nations

Viale delle Terme di Caracalla
00153 Rome, Italie
www.fao.fr