Crossfire: 'The rise in contract farming is likely to exclude smallholder farmers rather than benefit them'

SUKHPAL SINGH and MARTIN PROWSE

In this issue's Crossfire*, Sukhpal Singh and Martin Prowse discuss the inclusion of smallholder farmers in contract farming.*

Dear Martin

I am writing to highlight issues in the theory and practice of contract farming from the smallholder farmer perspective. There is no doubt that contract farming is emerging as an important business strategy for agribusinesses around the developing world. Nation states are encouraging it as a vehicle to promote agricultural development especially in the presence of the rise of global and regional value chains. In most of the developing world, there is a predominance of small and marginal farmers, though the term 'smallholder' is a relative one in that it refers to the limited resource endowments of such farmers relative to those of other farmers in each local context.

In this context, the application of a contract farming strategy for achieving competitiveness becomes problematic. If one of the purposes of such a strategy is to help develop smallholder farmers by bringing better technology, farm practices, and markets and prices as part of the inclusive growth agenda, then the transaction cost logic of agribusinesses inhibits this development.

The larger farmers are better able to provide the required quantity and quality of raw material (due to easy traceability as pooling is not resorted to, as in the case of small farmers) without much support from the contracting agency and even provide services like transport of produce and some primary processing because of their investment capacity. Also, the contracting agencies are able to pass on the risks and costs to these larger growers who also have better capacity to take risk. Therefore, contract farming agencies end up working with larger farmers who can afford upfront investments and take new risks as contract farming is definitely more expensive to undertake for farmers compared with production for the mainstream (open) market. Thus, it (contract farming) ends up being exclusionary/exclusive in nature. Also, since new crops and technologies and markets can be riskier, small farmers, being risk averse, tend to self-select themselves out of contract farming.

In fact, the exclusion of smallholder farmers starts with choice of locations/ geographies for contract farming where firms prefer better endowed

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regions. Then, the choice of crops, technology, and markets for contracted crops/produce determine who can participate. Further, the eligibility criteria for participation in contract farming are discriminatory as contracting agencies specify minimum land size, assured irrigation, financial resources, and so on without assisting with any of them. Finally, the terms and conditions of the contracts are designed to exclude some types of farmers who are mostly disadvantaged smallholders. Only where it is important to exploit family labour of small farmers, such as in gherkin production in India, or when the entire region is dominated by smallholders, do the contracting agencies tend to work with smallholders. But, even those are relatively large farmers within the smallholder segment. Many times, only contracted crop acreage of the growers is reported to claim smallholder inclusion.

Further, ineffective monitoring of contract farming practices by the state and the absence of collectives of smallholder farmers to negotiate with large contracting agencies leaves the smallholders, even if they are sometimes part of the arrangements of contract farming, worse off in terms of net benefit, dependence, and resource degradation. As a result, they move out of contract farming sooner rather than later.

Further, as contract farming grows in size and spread, it affects the open market as larger farmers no longer deal with such markets, and this harms smallholders still dependent on these markets, in terms of fair price discovery or other market practices. Finally, the 'reverse tenancy' (where larger farmers lease in smallholders' lands for contract farming, e.g. in India) encouraged by contract farming practically moves small farmers out of farming as larger and more resourceful farmers lease in their lands. Thus, smallholder lands are used for benefiting from contract farming by agencies and larger farmers.

I look forward to your response.

Sukhpal

Dear Sukhpal

Thank you for your letter. I appreciate our correspondence and hope it will bring clarity to an often emotive topic.

There is much to agree with in your opening statements: the greater interest by states and large firms in contract farming; that traceability and transaction costs can lead firms to prefer larger farms; that firms tend to prefer better endowed regions; that producer organizations and state regulation can offer some countervailing power; that smallholders are risk averse; and that contract farming can harm non-participants through making markets thinner.

However, some argumentation appears more polemical than precise. Precision is important here, so to start our debate I suggest we revisit the statement at hand. There are two questions: the probability of inclusion/exclusion; and, in the former case, the likelihood of benefits/harm for smallholder participants. Your letter answers both questions negatively: smallholders are excluded, and when included are harmed (along with the environment). If this really is the case, we should welcome the exclusion of smallholders, shouldn't we? Taking a wholly negative stance on both questions does not appear to be particularly incisive nor illuminating.

Moreover, we need a better working definition of smallholders. The relative endowment definition is not sufficient. To allow us to understand contract farming better, I suggest we treat the term ‘smallholder’ as a synonym for peasant. Following Ellis (1994), smallholders can thus be understood as farm households on customary land who are: 1) partially integrated into 2) incomplete markets – they are in 3) an uneven process of transition towards integrated market economies; are often 4) subordinated to more powerful social groups; and are subject to 5) internal differentiation.

We now run through these five points. Accepting smallholders are in an uneven and often fraught transition towards integrated markets (point 3) highlights how contract farming essentially increases the speed with which commercialization takes place. As you highlight, such a process certainly creates losers as well as winners. For example, contract farming increases the rate of differentiation within smallholder communities (point 5) via engaging the upper strata and integrating them more tightly in broader (international) markets (increasing community-level inequality, sometimes thinning spot markets, but also changing labour market dynamics for poorer households).

Accepting that smallholders are often subordinated (point 4) highlights that the extent of exploitation by a large firm (if this does occur) may not be so different from exploitation by other actors. The question is not whether exploitation occurs, but whether this is more or less intense compared to the counterfactual scenario. In a similar vein, accepting smallholders operate in imperfect markets (point 2) highlights the question: what is the alternative? Are input and output markets more or less reliable than the firm in question? Finally, recognizing the partial integration of smallholders in markets (due to subsistence production on customary land) highlights (point 1) how land has a social protection function. There is certainly a danger for smallholders when contract farming increases consolidation and landlessness (as rural labour markets do not operate in a beneficial manner for labourers).

Overall, I feel it is very hard to make strong, sweeping assertions regarding the ‘theory and practice’ of contract farming. In other words, this is not a black/white issue. The extent to which it includes/excludes, benefits/harms smallholders depends, inter alia, on demand, agrarian structures, the nature of the crop, the scheme in question, the actors involved, the contracts, and the regulatory environment. All these factors, and more, influence participation and impact. We need a nuanced approach. It is not appropriate to extrapolate a negative experience from one region/country to all cases of contract farming with smallholder communities in the South. We not only need to know ‘what works’, learning the lessons from schemes that have achieved some measure of success, but also ‘what works where’. Context is vital. Do you feel such a perspective offers a realistic agenda for bringing clarity to this contentious topic?

With best regards
Martin

Dear Martin

Thanks for your interesting reply. But, I would still disagree with many of your arguments in defence of contract farming and highlight their weaknesses as follows:

The essential purpose of my argument was not to say that smallholders are better off excluded from contract farming as you interpret it to be. We need contract farming for smallholders but in a manner that benefits them instead of excluding them or including them adversely. I believe that it is possible to leverage contract farming for smallholder benefit with appropriate policy mechanisms which regulate, monitor, and incentivize inclusion and enable smallholders to participate in it. Of course, the precise impact of contract farming depends on the context (i.e. actors and factors) and there is definitely no single model of contract farming.

As far as the definition of smallholder is concerned, the use of the term 'peasant' does not help beyond a point as it is as vague and elusive as a relative definition. A typical peasant as you define is hard to find as almost all types of smallholder interact with markets. But, even if we take an absolute definition of smallholder as one with less than or just 2 hectares, it won't make much of a difference as in the developing world, it may mean different things in different countries/regions depending on the type of land, access to water, and type of crops grown and yet may not show any less exclusion.

Comparing contract farming with existing exploitative systems and arguing that as long as it is not worse than existing alternatives, is being apologetic for contract farming. We are looking at contract farming as a solution to smallholder problems in situations of market failure or imperfections, and not as a less exploitative alternative! If the contracting firms discover their procurement prices based on malfunctioning and exploitative local wholesale markets (as in India), then where is the advantage, as we know how widely these market prices fluctuate and how manipulated they are by cartels of traders?

The question posed to us is more of a policy issue wherein we need to examine the policy mechanisms needed to make this new institution deliver inclusiveness and effective smallholder benefit. Since global and national drivers of value chains are involved in such arrangements projected as a 'triple bottom line' (people, planet, and profits) mechanism and promoted with public funds, it is important to ensure that they are leveraged better and firms take responsibility for inclusive and effective operations. And, I believe that better contract design, practice, and policy can help deliver inclusive contract farming and smallholder benefit.

I would also highlight that my observations are not based on evidence from one region or country but the whole of Asia, Africa, and parts of Latin America wherever contract farming has been tried in the last couple of decades. In fact, a recent paper by Bellemare (2012) based on 1200 households across regions and crops in Madagascar shows that those participating in contract farming had larger land holdings (1.5 times), higher assets (30 per cent), and higher working capital (100 per cent) besides higher education levels and greater membership of peasant organizations than their non-participant counterparts. This, it says, could lead to higher asset inequality, though participation of smallholders could also lead to decreased inequality. It recommends policy incentives for making contract farming inclusive of female-headed households, older farmers, the less experienced, and those not members of peasant organizations.

Finally, I would definitely agree with you that contract farming is context specific, but going by the large body of empirical evidence, it is important to watch its exclusionary nature and look for inclusive business models and policy and regulatory mechanisms to make it deliver smallholder development as far as possible so that we do not end up weakening existing institutions of developing world agriculture in the rush for contract farming.

With best wishes
Sukhpal

Dear Sukhpal
Thank you for your letter. It is a pleasure to debate this issue with you. I feel it helps us both realize how the outcomes from contract farming are so dependent on institutional design and context. Moreover, in spite of some assertions to the contrary, there is considerable common ground between us. For example, I'm glad we can agree on our definitional discussion: that smallholders can be understood as being partially integrated in incomplete markets within an uneven process of commercialization. We also agree that a nominal landholding threshold is not helpful (see, once again, Ellis (1994) on this point).

The purpose of highlighting counterfactual scenarios to contract farming was as an antidote to your first letter: this appeared overwhelmingly negative regarding both the probability of inclusion/exclusion and the benefits/harm for smallholders from participation. You rightly highlight deficiencies in agricultural markets (such as cartels) which can be a feature of spot markets. You are also right to suggest that contract and policy design need to ensure these practices do not spill over into depressing farm-gate prices within contracting schemes.

It is good to see the reference to the Bellemare (2012) article as this highlights how contract farming increases internal differentiation within the peasantry (a further point we both agree on). A further recent reference readers might find interesting is Abebe et al. (2013) who assess contract design attributes among potato farmers in Ethiopia. In this case, input market uncertainty was a greater consideration for participating in contract farming than insecurity in output markets.

I've enjoyed our discussions and hope we can continue to debate this issue in the coming months and years.

With best regards
Martin

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