Contract Farming as a Tool for Poverty Reduction in Africa

By Serge Adjognon

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CONTRACT FARMING AS A TOOL FOR POVERTY REDUCTION IN AFRICA

Serge Adjognon, McGill University
Anwar Naseem, McGill University

Executive summary

Increased demand for new, exotic and out-of-season products in developed countries, together with globalization, presents a great opportunity for the export of agriculture in Africa. However, poor farmers in Sub Saharan Africa (SSA) face a number of constraints that prevent them from taking advantage of those opportunities. Contract farming is a vertical coordination between growers of an agricultural commodity and buyers or processors of that commodity, and plays a significant role in alleviating those constraints. However, there are some problems related to Contract Farming Arrangements (CFAs). The most deprived people, such as smallholders and women in SSA, have a very limited access to contract farming. Also, farmers who get the chance to enter CFA usually have little bargaining power versus agribusiness firms, which makes it likely that they are exploited. Government and development partners should take actions to ensure everybody has equal opportunity to access CFAs. They should also promote collective action through farmer associations and investment in education to increase farmers’ bargaining power in CFAs. Welfare impact of contract farming needs to be reevaluated using more accurate research methodologies such as randomized control trials.
Policy Brief: Contract farming as a tool for poverty reduction in Africa

Policy goals

This policy brief is a contribution to *stimulating sustainable economic growth*, which is one of the three priority themes on which Canada’s international assistance is focused.

Significance of the issue being addressed

The Millennium Development Goal of halving the number of people in poverty and suffering hunger by 2015 cannot be attained unless the most deprived smallholder farmers and women, who represent the greatest proportion of the poor in developing countries, are offered better opportunities to improve and commercialize their agriculture. Even though Contract Farming (CF) has a great potential to connect small farmers to the market, it is not spontaneously geared toward the most deprived groups because of the high transaction costs involved. This is a serious problem and needs to be addressed before we can confidently think of CF as a real tool for poverty reduction in SSA.

Canada’s interest in the issue

Canada is among the largest and key foreign aid donors that seek to support projects, activities and policy interventions promoting global growth and development. To ensure that Canadian funds are used in ways that deliver the greatest benefits to the intended beneficiaries, it is important to understand the role and impact of different policy interventions, institutional arrangements and development strategies that would harness rapid and inclusive growth. This brief seeks to explore whether the supporting Contract Farming Arrangements would result in meeting this goal.

Policy recommendations

- Government and development partners should take actions to ensure that everybody, including women, have equal opportunity to access contract farming. They should also promote collective action through farmer associations and investment in education to increase farmers’ bargaining power in contract farming arrangements.
- The welfare impact of contract farming needs to be reevaluated using more accurate research methodologies such as randomized control trials.
Introduction

A high proportion of the poor in Sub Saharan Africa (SSA) are subsistence farmers operating with low input level, low access to market and living on low-value traditional crops. Even though globalization, market liberalization and development of rural infrastructure are providing new market opportunities, the poor cannot take advantage of these because of low capital, limited access to credit, risk aversion, and a poor connection to the market. Contract Farming Arrangement (CFA) has emerged as a means to alleviate those constraints and thus enhance the productive capacity of farmers. Under contract farming, the purchaser (local or international agri-business firm or trader) provides farmers with inputs, credit, technical advice, and market services. In return, farmers produce a certain quantity and quality of crop, and sell them exclusively to the purchaser. What role can CFA play in stimulating sustainable economic growth in rural economies and reducing poverty in SSA rural communities?

Theoretically, CFAs allow farmers to have access to an array of agricultural services which they would otherwise not have access to. By reducing risk, uncertainty and transaction costs, they have the potential to link farmers to markets and stimulate agricultural production in the face of globalisation. The World Bank has officially promoted contract farming as a tool for poverty reduction in Africa (WB, 2007). Also, a large body of empirical literature has been developed and confirmed a positive impact of CFAs on participants’ income (Bolwig et al., 2008; Bellemare, 2010; Miyata et al., 2009; Bijman, 2008). However, the non-random selection of farmers into CFAs makes it difficult to conclude a causal impact of CFA participation on smallholders’ welfare. Besides, who are the participants in CFA? Clearly, there are conditions to participate in a CFA. Amongst others, the ownership of land is a crucial condition and is more likely to exclude the most deprived groups such as women. Also, the low bargaining power of farmers vis-a-vis agribusiness firms makes it legitimate to fear that the former may be exploited.

This policy brief presents an overview of contract farming in SSA, highlighting its potential for stimulating economic growth in African rural economies, and how governments and development agencies can create and enforce conditions under which the most deprived groups, such as women, can participate in and benefit from CFAs. Besides highlighting the key insights from available literature, the brief will also identify existing gaps in our understanding of CFA. The brief will explore whether new research methodologies such as randomized control trials could be used in future research to draw definitive and credible conclusions regarding the relationship between CFA participation and smallholder welfare.
**Definition of contract farming**

Contract farming has been defined differently by many authors. But overall the definitions refer to the same idea. CFA is a vertical coordination between growers of an agricultural product and buyers or processors of that product. There is basically a central processor or marketing firm that purchases the harvest of independent farmers and the terms of the purchases are arranged in advance through contract. Through such arrangements the purchaser commits themselves to providing production support such as credit, inputs, farm machinery rentals, technical advice, and market services to farmers, and to purchasing the commodity. How much of the commodity will be bought and what price will be paid are specified beforehand in the terms of the contract. In return, farmers commit themselves to providing a commodity according to some quantity and quality standards also specified in the contract (Glover, 1994; Eaton, Shepherd *et al.*, 2001; Mansur, Tola *et al.*, 2009).

A formal definition used in Setboonsarng (2008) referred to contract farming as a “contract between a farmer and a purchaser established in advance of the growing season for a specific quantity, quality, and date of delivery of an agricultural output at a price or price formula fixed in advance”. This definition is quite clear and simplistic, but does not provide much information about the purchaser. Yet it specifies some key elements of the agreement between the two parties.

A complementary definition by Eaton *et al.* (2001) and Bijman (2008) refers to contract farming as “…an agreement between farmers and processing or marketing firms for the production and supply of agricultural products under forward agreements, frequently at predetermined prices”. This definition is vague about the components of the agreement but is more precise about the nature of the purchaser. It can be a processing firm or marketing firm. Bijman (2008) mentioned, in addition, that it can be a private or public entity.

From the previous definitions, we can distinguish 3 main components or areas of commitment in a contract farming arrangement (Eaton *et al.*, 2001):

- Market provision: The farmer and the contractor commit themselves respectively to supplying and purchasing a specific agricultural commodity;

- Resource provision: The buyer commits itself to providing credit inputs and technical advice to the farmer;
- Management specifications: The farmer in turn agrees to follow recommended production methods, input regimes, and cultivation and harvesting specifications.

**Types of contract farming**

Depending on the type of contractor, the type of product that they are most suitable for, the intensity of vertical coordination between farmer and contractor, and the number of key stakeholders involved, contract farming schemes can be classified into five basic models (Eaton *et al.*, 2001; Bijman, 2008):

The first model is the **centralized model** and is generally referred to as the classical model where a central purchaser contracts with a large number of farmers. There is a high degree of vertical coordination between farmers and contractor which allows for strict quality controls of the product, and quantity is determined at the beginning of the growing season. This model is typically used for products such as sugar cane, tea, coffee, milk, etc., that require a high degree of processing because the quality of the final product after processing is tightly dependent on the quality of the inputs used.

A variation of this model is the **nucleus estate model** in which the agribusiness contractor not only purchases commodities from independent farmers but also invests in production activities through a plantation estate. The central estate, usually consisting of state owned farms that have reallocated land to former workers, ensures provision of raw materials for the processing plant but can also be used for research and breeding purposes. The degree of vertical integration varies for this model, and it is used more often for perennial crops.

A third model is the **multipartite model** whereby the contractor consists basically of a joint venture established between an agribusiness company and a local entity. Public or private financial institutions, extension services and input providers may be part of the arrangement. Many governments in developing countries became involved in contract farming through this model during the liberalization process in the 1980s and 1990s. Vertical integration may be very intense (Vermeulen and Cotula, 2010).

The **informal model** involves individual entrepreneurs or small firms with which more informal and verbal contracts are signed on a seasonal basis. The contractor here has less economic and political power and cannot provide much supporting services to farmers. Therefore the provision of technical support is left to government agencies. The degree of
vertical integration is very low. This model is used for products which require a low degree of processing, such as sorting, grading and packaging.

The last model, the **intermediary model**, is a combination of the centralized and informal models. It involves at least three parts. There is a contractor (processor or trader) who contracts formally with an intermediary collector (or middleman). Then the collector then contracts with a number of individual farmers. This model presents some limits for vertical integration. The main contractor does not have a direct link with the farmers and so has very little control over the production process.

It is important to note that contract farming is mostly used for cash crops that are usually not part of the daily diet of the contracting farmers. Therefore, there is clearly a trade-off between the food security priority (to the extent that one talks about subsistence crops) and the economic growth priority (increasing income and opportunities, not necessarily food production).

**Potential in stimulating economic growth in African rural economies**

The increasing demand for new, exotic and out-of-season products in developed countries together with globalization and market liberalization provides new opportunities for the export of agriculture goods in SSA. However SSA farmers often are unable to take advantage of these possibilities due to a number of constraints.

First, there are considerable information asymmetries between farmers and potential buyers, resulting in sub-optimal outcomes. As agricultural markets are very risky and frequently weak in SSA, farmers’ potential to increase productivity and income is constrained by the lack of information about efficient production technologies and market opportunities. Second, even when information is available to them, they are also constrained by their limited access to credit, due to a lack of collateral and the high interest rates applied. New technologies are more costly and, without credit, they cannot afford to adopt them. A third main constraint is that small farmers are usually more risk averse. While they face competition from producers who have adopted new and eventually more productive technologies, they are often reluctant to adopt those technologies themselves because of the high risks and costs involved. Indeed, they prefer to allocate their limited resources to the
production of subsistence crops in order to guarantee themselves a minimum supply of food, instead of producing commercial crops for a market led by a high level of risk and uncertainty (Bijman, 2008).

Under CFAs, the agribusiness companies basically commit themselves to removing those constraints by providing not only market opportunities to farmers, but also more productive technologies, better inputs, credit and supporting services. Indeed, they have a direct interest in doing so in order to guarantee the good quality of the raw materials they purchase from the farmers. Therefore, contract farming enables farmers, especially small-scale farmers in developing countries, to gain access to good quality inputs and production services, credit, appropriate technology, and market opportunities that would not otherwise have been available to them (Glover, 1994; Eaton et al., 2001).

Farmers can gain access to credit directly through the contract farming scheme or indirectly from banks, using contract farming as collateral. In the multipartite model of contract farming for example, the agribusiness company can become involved in a joint venture with a local bank that will provide growers with credit for the purchase of fertilizer, seeds, and other inputs. At harvest time, the company will pay growers the contract price, but take off a sum that goes to the bank to repay its loan to the grower (Glover, 1994; Vermeulen and Cotula, 2010).

As described in Box 1, many agricultural crops have been produced under contract farming arrangements in Africa, and participant farmers have benefited from new opportunities to earn income.
The Challenge of Expanding CFAs

Smallholders’ access to CFA

In spite of the great potential of contract farming to improve agricultural productivity and income of participant farmers, there is still debate on its real implication for poverty and inequality alleviation. Several authors think that contract farming, as it currently operates in Africa, is of little value as instruments of development because they rely on large, rather than
small-scale farmers. In order to minimize transaction costs, to ensure uniformity in the product, and for the purpose of economies of scale, agribusiness firms usually prefer to deal with a small number of large farmers than a large number of small farmers. For example, Kenya has been pointed out as a success story in export horticulture based on contract farming. However, the proportion of fresh fruits and vegetable sourced from small scale farmers in Kenya has been steadily declining for years, from 75% in 1992 to 18% in 1998 and even more today, as exporters find it more convenient to deal with a few large commercial farms than with many smallholders (Sautier, Vermeulen et al., 2006).

It is commonly admitted amongst academics that participation by the most deprived people in contract farming is very limited (Eaton et al., 2001; Sautier et al., 2006; Bijman, 2008). The conditions to enter CF schemes are such that it is unlikely that farmers of the most deprived groups, especially women and some small-scale farmers, be selected for contract farming. In some societies, the unequal access to CF schemes may even reflect to some extent the prevailing inequality in the society. For example in South Africa, the racial inequality translates into inequality in access to contract farming. Indeed, the volume of supply from black farmers was shown to be very limited both in the chicken industry and in the fresh products industries. In 2006, only 3.6% of fruit and vegetables production was supplied by 455 black contract farmers while 74% was supplied by 4,723 commercial (mostly white) farmers, reflecting some racial inequality present in South African agriculture (Sautier et al., 2006).

One of the main requirements for eligibility into contract farming schemes is land ownership. Having a piece of land that fulfills some precise characteristics related to size, quality, geography, and topography is crucial for admission in contract farming schemes. As indicated in Box 2, to enter the Mumias Sugar Company CF scheme in Kenya, a farmer must be a registered owner of the land on which the purchased crop is grown (Glover and Kusterer, 1990). But land is very unequally distributed in SSA, and security over ownership of land is very weak. In South Africa, about 86% of agricultural land is controlled by 46,000 commercial farmers, while the remaining 14% is occupied by 3 million small-scale subsistence farmers. Therefore, many very poor and needy small-scale farmers are excluded from contract farming schemes (Sautier et al., 2006).
Box 2: ELIGIBILITY REQUIREMENTS FOR THE MUMIAS SUGAR COMPANY CONTRACT FARMING ARRANGEMENT IN KENYA

“The Mumias Sugar Company in western Kenya is a multipartite arrangement principally involving Booker Agriculture International (BAI), the Commonwealth Development Corporation (CDC) and the Government of Kenya. The World Bank has also contributed to the financing, particularly in the early stages. Mumias began with an 19,750 acre nucleus estate in 1972 (now 8,400 acres); it now processes cane from 33,000 outgrowers, who provide about 90% of the plant's throughput. The company employs 5,000 full-time and 9,000 part-time workers, including field and factory operations.

The eligibility requirements for admittance to the outgrower programme complete this sketch of grower characteristics. To enter the programme, a farmer must:

(a) cultivate land within 8 miles of the factory
(b) be a registered owner of the land
(c) have suitable soil for cane
(d) have land accessible to tractors
(e) grow a minimum of 3 acres of cane and 2.5 acres of food crops and/or pasture
(f) form part of a contiguous plot of cane land at least 15 acres in area (i.e. several neighbours must also grow cane).”

Source: Glover and Kusterer (1990)

Women’s access to contract farming

The land ownership requirement discussed above is particularly discriminatory against African women because few women in Africa own land themselves. The FAO, documenting the gender gap in agriculture, stated that compared to men, “women across all developing regions are less likely to own or operate land; they are less likely to have access to rented land, and the land they do have access to is often of poorer quality and in smaller plots”(FAO, 2011; p23). Drawing from the most comprehensive data on women’s access to land (FAO Gender and Land Rights Database, 2010f), the study found that women represent only 15% on average of all agricultural land holders in Sub Saharan Africa and, in addition to
being more likely to hold land, men also typically control larger land holdings than women (FAO, 2011). This translates into a severe gender disparity in access to land and has important implications for gendered access to contract farming schemes in Africa.

Most of the women in Africa receive the piece of land they farm from their husband. Some contract farming schemes will only enroll heads of households as members, or will register all farms under the head of the household’s name. This means that the head of the household is considered responsible for all the household plots involved in the contract, and receives payment for the production made from all those plots, including the plots controlled by women. The husband, as head of the household, is considered by CF companies as the owner of the land and contracts and payments are allocated to men for work carried out largely by women. This practice is a clear discrimination against women and can raise problems in intra-household relationships (Chan, 2010).

In addition, contract farming is used mostly for the production of cash crops. And in many African societies, cash crops are typically perceived to be men’s responsibility, while women are considered responsible for producing subsistence crops to feed the household. But, some contract farming schemes require that a farmer must produce a minimum volume of a specific crop or type of crops in order to be eligible. This can make it difficult for women to become members because the limited amount of land that women control is bounded to their responsibility for producing subsistence crops to feed the household. It is therefore difficult for women to free up some land in order to participate in contract farming arrangements. And even if they could do so, men might take over production and income because they are responsible for cash crop production (Chan, 2010).

Women’s participation in contract farming is also compromised by their poorer education and literacy, which can create a barrier to joining formal contract farming. Usually, women in Sub Saharan Africa will rely on their literate husband or son to be their representative when it comes to signing formal contracts that require a minimum level of literacy. Therefore it is easier for agribusiness firms to deal only with men, amongst whom the literacy rate is higher.

**Improving the bargaining power of contract farmers**

Another important problem that may hinder farmers’ benefits from contract farming schemes is their limited bargaining power versus agribusiness firms. Even though contract farming can
contribute to welfare improvement, the low bargaining power of the farmers who are participating in contract ventures make them face a number of risks. The bargaining power of the farmers is reduced further when there is a monopoly of a single crop by a sponsor; that is, the sponsor is the only company that needs the crop produced by the farmers under the contract farming arrangement. As Mansur et al. (2009) said: “Contracting is fundamentally a way of allocating risk between producer and the contractor; the former takes the risk of production and the latter the risk of marketing” (Mansur et al., 2009; p.3). But there are many cases where farmers in contract farming face increased risks passed along to them by the agribusiness firm.

First, farmers in contract farming may face increased production risks. In cases where a new crop is being introduced by the contract farming venture, for example, inadequate prior field tests may lead to lower than expected yields. In such cases, farmers find themselves bearing the responsibility of a bad outcome even though the problem is related to the quality of the inputs provided to them by the agribusiness company.

Also, contract firms may transfer some market risks to farmers through manipulation of quotas and quality specifications. Indeed, the contractor firm usually retains the right to reject “substandard” products. But in case of inaccurate forecasts of market size and price levels by the company, or when the market unexpectedly collapses leading to a situation of excess of production, for example, there are increased market risks. Then the company may want to manipulate the quality requirements and disqualify part of the farmers’ production. This way they reduce purchases from the farmers while still appearing to honor the contract. This is an abuse of the farmers by transferring some of the market risks to them (Glover, 1994; Eaton et al., 2001).

**Implications of the limited access of women and smallholders into CFAs**

Since the most deprived farmers such as smallholders and women are less likely to be selected into contract farming schemes, those groups are trapped into a poverty cycle. Many development policies aim at improving the wellbeing of women and the most deprived farmers in Sub Saharan Africa because they need help the most. The World Bank also considers that successful contract farming can act as an effective tool for poverty reduction in developing economies (World Bank, 2007). But contract farming cannot contribute durably to
the Millennium Development Goal of halving the number of people in poverty and suffering hunger by 2015 if the poorest are not included. Even though the easiest way to reduce head count ratio – the percentage of people falling below the poverty line – is by first helping those who are just below and very close to the poverty line, not helping the poorest keeps the poverty gap very high. Furthermore, the great majority of the new born generation enter life into extreme poverty and have very few opportunities to get out of it, which in the long run would lead to a re-increase the head count ratio. The marginalized groups that are unable to benefit from contract farming, women and small-scale farmers, not only lose out on the direct benefits of contract farming - which is the income from crop sales - but also on skills and capacities provided by the companies they may have gained as a result of participation, such as technical training, extension services and production inputs. Consequently they suffer from poverty today and are denied the opportunity to get out of poverty in the future. Inequality is then sustained amongst people and genders in the society.

Moreover, the people who cannot have access to contract farming schemes rely on the spot market for selling their products. But as agribusiness firms start sourcing their products from contract farmers, the share of the spot market in the sales of the products may decline. Hence those farmers who are stuck with the spot market are likely to be made worse off because of the displaced demand due to contract farming.

Besides, the fact that those participants in contract farming schemes are not randomly selected raises some questions about the validity of research conducted so far about the welfare impact of CF. Clearly those studies cannot conclude there is a causal welfare effect of contracts on farmers because of the selection bias introduced by the way people are selected into the schemes. The following section discusses this problem more deeply.

**Toward a better understanding of contract farming and its impact on wellbeing**

The fact that the firm strategically chooses the farmers to whom it offers contracts creates a selection problem for researchers who seek to estimate the welfare effects of participation in CF. Due to the non-random selection of participating farmers into contract farming schemes, the handful of empirical studies on the welfare effects of contract farming participation have faced methodological difficulties in establishing the causal impacts of contract farming. Indeed it is difficult to determine whether observed welfare changes can be
ascribed to contract farming participation, so the degree to which participating farmers benefit from the schemes remains uncertain. In particular, a higher income per capita in contract farming may merely reflect the fact that more industrious or more skilled farmers have a greater likelihood of becoming contract farmers. In other words, these contract farmers might have relatively high incomes regardless of whether they participated in the contract farming programs or not. In this case, the calculated effect of participation in contract farming would include the effect of these unobservable characteristics in addition to the effect of contracting, thus over-estimating the effect of contracting. Various non-experimental methodologies have been used in the literature to overcome this selection bias problem.

One way to deal with selection bias is to use the treatment effects model (also called the Heckman selection–correction model). This model involves two equations: the selection equation and the outcome equation. The selection equation is a regression that helps identify the factors that affect the probability of participating in contract farming. From this first regression, a coefficient can be calculated, called the Inverse Mills ratio (IMR). The outcome equation is also a regression that estimates per capita income as a function of various household characteristics, the contract dummy variable, and the Inverse Mills ratio (IMR). The IMR is calculated from the selection equation, and adjusts the outcome equation for selection bias associated with the fact that contract farmers and independent farmers may differ in unobservable characteristics (such as industriousness, skills, or intelligence). Thus, this term corrects for possible selection bias and yields unbiased and consistent estimates in the income model.

A counterfactual simulation can also help sort out the impact of contracting on per capita income. In brief, the key to this approach is to estimate households’ counterfactual per capita income and compare these to actual per capita income. The counterfactual per capita income of a contract household is defined as the hypothetical per capita income that it could have earned had it farmed like a (typical) non-contract farm. Similarly, the counterfactual per capita income of a non-contract household is defined as the hypothetical per capita income that it could have earned had it farmed like a (typical) contract farm. Higher actual than counterfactual per capita income for contract households would indicate that contract households would have been less profitable had they operated like a non-contract household. Similarly, actual profits that are lower than counterfactual profits for non-contract households would indicate that non-contract households would have been more profitable had they operated like a contract household.
However, recent advances in impact evaluation have made use of randomized trials, which have shown promise in providing a clearer picture of different policy interventions. An alternative and useful way to evaluate the causal impact of contract farming participation is then to use experimental methods, such as randomized control trials, in which smallholders are randomly assigned to a treatment group of CFA participants or to a control group of nonparticipants. This way, CF participation is completely exogenous and this eliminates bias in estimates of the welfare effects of CF. But no study has done this so far for evaluating the welfare benefit of contract farming. The main problem here is that profit-seeking firms are unlikely to agree to randomization. Indeed, if participants to CFAs were to be selected randomly by agribusiness firms, then there would be a loss of income incurred by the firm, due to the fact that higher net profit or lower costs could be realized by contracting with other selected farmers. Such strategy cannot be considered rational from a profit maximizing firm point of view, unless the agribusiness firm is compensated for the loss of income incurred. Therefore, by using appropriate incentives policies, Governments and Development Institutions can encourage agribusiness firms to randomly choose the participants into CFAs.

Besides, it is also important to note that the impact of contract farming includes not only direct impact on contract farmers but also the indirect impact on non-contract farmers through farm labour and industry employment. Indeed, when farmers commit themselves to supplying higher quantities of an agricultural product to a buyer, family labor is usually not sufficient anymore and they rely more on hired labor. This way they give employment to those who do not meet the requirements for being selected into the CFA schemes. Also, when processing firms are set up locally, the increased production requires more labour for the processing activity, driving up the industry employment. Impact evaluation studies should therefore take this into account in estimating the benefits of CFAs.

**Actions for Governments and Development Institutions**

In conclusion, it is clear that in spite of its high potential to stimulate economic growth, contract farming is not spontaneously geared towards the most deprived farmers because of the high transaction costs involved. More importantly, women are largely excluded from contract farming. As long as the most deprived people are excluded from contract farming schemes, the only way contract farming can participate in poverty alleviation is through generating labour employment on farms and processing plants, rather than having a direct effect on smallholder producers. This is not necessarily bad, but neither may it be enough to
fully profit from the potential of CFAs. Therefore actions need to be taken in order to create and enforce conditions under which the most deprived groups such as women and small-scale farmers can participate in and benefit from Contract Farming Arrangements. As part of these actions:

- Government and Development partners should work together with agribusiness firms to ensure that membership criteria offer equal opportunities to everybody. Some political imperative or requirements could be used that increase openness and commitment from agribusiness firms to purchase from women and small-scale farmers. For example it may be made mandatory for any agribusiness firm that at least 1/3 of its contract farmers should come from a specific deprived group. Moreover, licenses for operating as an agribusiness firm should be allocated conditional on compliance to that rule. This will certainly raise some monitoring and enforcement issues that would be considered more deeply if such a policy were to be implemented. Furthermore, knowing that the firm seeks particular attributes among its suppliers, Governments and Development agencies may step in to reduce transaction costs of contracting with poorer farmers through group creation, agricultural extension, provision of certification services, investment in roads or irrigation, etc.

- Land reform programs should be promoted that bring change in ownership structure instead of dividing the land into smaller units. For example, it could be possible to distribute land to groups of farmers collectively, such as through cooperatives. This will avoid taking the farms to pieces, since the relation with agribusiness buyers is lost with the dismantling of the farm (Sautier et al., 2006). Indeed, since firms find it costly to deal with individual small farmers with very small land plots, land could be redistributed to farmers as a group so that the group as a unit can be responsible for a land size big enough to make it profitable to the agribusiness firm to deal with them. Then an internal organization rule would dictate how tasks and benefits would be allocated within the group.

- To increase women’s participation and benefit from contract farming, intra-household relations should be taken into account by agribusiness firms. Allocation of contracts and payments should be made to the principal workers rather than the
heads of the household. Thus, women will be able to register into contract farming in their own name and receive payment for the work that they do. Promoting literacy among women will also help in increasing their chances to enter into and benefit from contract farming. Therefore, young girls should be sent to school. This will definitely reduce current and future transaction costs of dealing with rural women CFAs.

- Participant farmers’ bargaining power also needs to be enhanced in order to increase their benefit from contract farming (Setboonsarng, 2008). To this end, Government and Development agencies should discourage the use of monopoly power by some agribusiness firms, and promote education and collective action amongst farmers. For example, taxes on exports could be set by the government in a way that encourages many agribusiness firms to enter the market so that farmers have many alternative firms they can contract with. This raises their bargaining power versus the contractor and will avoid situations in which they are exploited.

- Government and development organisations should also work directly toward alleviating the constraints faced by the smallholder farmers in order to reduce the need for contract farming. As mentioned in this brief, farmers in Sub-Saharan Africa face a set of constraints such as lack of information, poor connection to the market, and lack of input and credit, which raise transaction costs of participating in the market. CFAs are meant to alleviate those constraints and reduce those transaction costs. But if those constraints can be tackled directly by Government and Developments partners, the need for contract farming would be reduced. CFAs are actually most relevant only the early stage of economic development when transaction costs are the highest, and its main functions are facilitating transformation from subsistence to commercial farming and stimulating growth and development of the agro-processing industry. But when the market develops and reaches the stage of mass production and spot market transaction, the market functions well, and the importance of contract farming is relatively limited (Setboonsarng, 2008). This implies that while contract farming is helpful for making up for current imperfections in the agricultural market, it should not be relied upon in the long run. Effort should also be made to directly improve the market for agricultural development in SSA. Contracts would then be just a short
term solution awaiting the results of the long term market development policies that Government and Development Institutions have to design at present.

- Finally, we suggest that Government and Development Institutions support and fund new research methodologies such as randomized control trials in future research to draw definitive and credible conclusions regarding the relationship between CFA participation and smallholder welfare.

This guide describes in detail the general modus operandi, internal functions and monitoring mechanisms of contract farming. It aims to provide advice to managers of existing contract farming companies on how to improve their operations, and to companies that are considering starting such ventures on the preconditions and management actions necessary for success. It also gives guidance to government officials seeking to promote new contract farming operations or monitor existing operations. The advantages for farmers are clearly explained and also the problems they face. Different models of contractual arrangements are described, e.g., centralised, nucleus estate, multipartite, informal and intermediary, and contract formats and specifications are reviewed. Advice is also provided on coordinating production, managing the agronomy and farmer-management relations.


This paper presents a review of the literature on contract farming (CF), focussing on recent empirical research on the economic impact of CF. The paper starts with an explanation of the phenomenon of CF, providing definitions, typologies, models and objectives. Using a Transaction Costs Economics framework, the paper explains for which products and markets CF seems most suitable. The empirical literature on CF is assessed by answering three questions: Why do smallholders engage in CF? Are smallholders included in or excluded from CF arrangements? What impact does CF have on smallholder income and rural development? Finally, the paper identifies the conditions under which smallholders are most likely to benefit from CF schemes.
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