

Contracting Out of Poverty: Experimental Approaches to Innovation in Agricultural Markets with Small Farmers

International Food Policy Research Institute (IFPRI)

Country/Region:	Tanzania, Vietnam and Peru
German participation	University of Hohenheim, University of Göttingen
Leading scientist:	Dr Maximo Torero
Duration:	Jan 2008 – Dec 2010

Initial situation

Poor, rural farmers are often left out of the market as they may not be able to compete with larger farmers. Although contract farming has shown to be an effective way of integrating farmers into domestic and international markets, its benefits have gone mainly to medium-sized and relatively more educated farmers. These market-entry barriers have different reasons. On the one hand, small-scale farmers cannot exploit economies-of-scale in production; on the other hand they have larger difficulties to commit to contracts than large-scale farmers. Smallholders' ability to invest in contractual arrangements or benefit from them is limited by size margins and fixed costs. Additionally, significant monitoring costs are needed to reduce the probability of smallholders reneging on their contracts. Due to their difficulties in providing processing companies with consistent quantities of high-quality products, smallholders' power in contract enforcement is limited. While technological barriers to contract farming are real and important for small-scale farmers, it is crucial to

highlight evidence showing that incentives-based problems are partially responsible for the failure of contract farming.



Approach of the project

We developed contracts that had been tested both in the laboratory and in the field to improve small-scale farmers' welfare in Vietnam, Tanzania and Peru. These contract structures were implemented in a field setting in these countries in order to evaluate them under the following conditions:

- diverse geographical environments,
- local potential for contract farming with agricultural products,
- on-site technical support received to implement the contract structures

The selection of the rural communities for contract evaluation was conducted through a typology of micro regions that will serve as a scaling-up device of the results of the project. The proposed research approach will show suitable contract structures for the respective regional conditions and will measure improvements to overall farmer welfare (income and poverty levels).



Major results achieved

New contract designs have been implemented with private companies in Peru, Vietnam and Tanzania. In the case of Peru, an agreement has been made with a mango producer, while in Vietnam and Tanzania milk processors were contracted. The experimental contract design included credits from the local credit union (backed by the contracting firm) and a price incentive for an increase in production of first-quality produce (both for milk in Vietnam and mangoes in Peru). While in Peru contract evaluation is finished, data collection has been started in Tanzania and Vietnam. So far, the evaluation has shown that the contract design worked successfully in the case of Peru. As prices were higher

with the contracts than on traditional markets, farmers received higher incomes than without contracts. Moreover, they received more inputs or financial assistance from the mango firm, and the raise in price incentives increased the quality of the produced goods. In all cases the contract designs improved farmers' retention and loyalty with the contracting company. Farmers who received the treatment contracts (credit, price incentives for better quality) sold a greater proportion of their production to the contracting firm.

The Inter-American Development Bank agreed to develop a fund for applying similar contracts in Central American countries; this will be launched in the following months.

Expected impact

The project will help greatly in designing new institutional mechanisms providing smallholders with an easier access to dynamic markets. Through efficient contract farming arrangements the welfare of the poor will be improved. Moreover, the contract designs that are tested in this project could easily be replicated for other countries in Sub-Saharan Africa, Asia, and Latin America; as well as for other crops. In addition, IFPRI will strongly support the implementation of the results of these projects in different countries by promoting them through policy briefs, workshops and conferences. These will be aimed at different stakeholders, such as policy makers, food processing companies, and farmers associations.

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