INTERNATIONAL FOOD POLICY
RESEARCH INSTITUTE
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CONTRACTING OUT OF POVERTY:

EXPERIMENTAL APPROACHES TO INNOVATION IN AGRICULTURAL MARKETS WITH SMALL FARMERS

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MTID PROJECT SPOTLIGHT

Maximo Torero, Ruth Hill, and Angelino Viceisza

INITIAL SITUATION

Poor, rural farmers are often left out of the market. They may not be able to compete with larger farmers who can provide firms with consistent quantities of high-quality products. These barriers to entry for small farms may be due the inability of small farmers to exploit economies-of-scale in production and to their inability to commit to a contract. Although contract farming has proven 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. The reasons why smaller and less educated farmers have been excluded from contract farming include size limitations and fixed costs, the significant monitoring costs needed to reduce the probability of small farmers reneging on their contracts, and the limited power of small farmers in contract enforcement, which may limit small farmers' ability to invest in such arrangements or benefit from them. While for technological barriers to contract farming are real and important, it is also crucial to highlight evidence which shows that incentives-based problems are partially responsible for the failure of contract farming.

PROJECT APPROACH

We have developed contracts that have been tested both in the laboratory and in the field to improve small farmers' welfare in Vietnam, Tanzania, and Peru. Our innovation is that we implemented these contract structures in a field setting, which is an ideal venue because of the diverse geography, the potential for contract farming with agricultural products, and the on-site technical support provided to implement the contract structures. The contracts have been applied in several rural communities selected 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 which contract structures work under what conditions and will measure improvements to overall farmer welfare (income and poverty levels).

MAJOR RESULTS ACHIEVED

This project is in its final stage. At this point, we have implemented new contract designs with private companies in Peru, Vietnam, and Tanzania. In the case of Peru, the agreement is with a mango producer; in Vietnam and Tanzania, it is with milk processors. Our experimental contract design includes credit from the local credit union (backed by the firm) and a price incentive for an increase in production of first-quality produce (for milk in Vietnam and Tanzania and for mangoes in Peru). This contract design has been successful. In the case of Peru, farmers in our treatment group did receive more inputs or financial assistance from the mango firm. Overall, an increase in price incentives increased the quality of the products produced by the small farmers and the loyalty of the small farmers to the contracting company.

In all cases, the contract designs improved farmer retention with the contracting firm. Farmers who received the treatment contracts (credit and price incentives for better quality) sold a greater proportion of their production to the contracting firm.

EXPECTED IMPACT

We believe that this project will help greatly in designing new institutional mechanisms to provide smallholders with access to dynamic markets through efficient contract farming arrangements and to improve the welfare of the poor. Moreover, the contract designs that we have tested in this project could easily be replicated in other countries in Sub-Saharan Africa, Asia, and Latin America, as well as for other crops. IFPRI will strongly support the implementation of the results of this project in different countries, given the Institute's objective to develop international public goods.

Maximo Torero (m.torero@cgiar.org) is Division Director**, Ruth Hill (r.v.hill@cgiar.org)** is a Research Fellow, and **Angelino Viceisza (a.viceisza@cgiar.org)** is a Postdoctoral Fellow with the Markets, Trade and Institutions Division of the International Food Policy Research Institute.

Project collaborators: George Mason University
University of Hohenheim
University of Göttingen.
Peru: Group of Analysis for Development (GRADE)
Tanzania: Sokoine University
Vietnam: Institute of Policy and Strategy for Agricultural and Rural Development **(***IPSARD)*

INTERNATIONAL FOOD POLICY RESEARCH INSTITUTE
2033 K Street, NW, Washington, DC 20006-1002 USA
T +1 202 862 5600 • Skype: ifprihomeoffice • F +1 202 467 4439
ifpri@cgiar.org • www.ifpri.org

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