



Contract Farming Practices in China

Key policy messages (policy recommendations)

Based on practices in rural China, we have the following policy recommendations for policymakers to promote the benefits for small household farmers in contract farming.

1. The construction of a trust-oriented social relationship between big companies and small farmers still needs to be improved

The realistic basis for the effective operation of contract farming is that companies, cooperatives and farmers share a good basis for social trust. However, the field research results show that farmers are not willing to sign long-term contracts with companies. One reason is that farmers lack the ability to understand and sign a formal contract due to their low level of education. Another reason is that there is a lack of social trust between a big company and small farmers. In contrast to formal contracts led by big companies, farmers have much more trust in their acquaintances within rural society. This is a characteristic of rural communities, in which farmers build up social relationships and share rural culture based on geo-relations and kinship. So when companies and small farmers lack the confidence to invest in future markets, both are likely to make short-term deals rather than long-term ones, even if they do not enter into a contractual relationship. Therefore, at the initial stages of cooperation between the parties, the grassroots government, including village committees, can act as a “bridge” between companies and farmers. The government could consider intervening in an appropriate way to promote the establishment of a social relationship between big companies and small farmers.

2. Farmers’ ability for self-organisation could be enhanced

Smallholder farmers often lack marketing and bargaining power when they work with large companies. Even if a third party is placed between the company and the farmer, the interests of the farmer may not be guaranteed. Thus, improving the organisational competence of small farmers can strengthen their power in terms of product standards, pricing, and other aspects, thereby

enhancing their ability to acquire value in the value chain. Farmers need organisations that can negotiate on an equal footing with enterprises. Otherwise, it is difficult to guarantee that the interests of farmers will be protected, and the cooperative relationship between the two parties will be stable and sustainable. Therefore, local government, particularly the Bureau of Agriculture and Rural Development, could cultivate and support rural cooperative organisations. To support cooperation among small farmers in the same areas and producing the same crops, local government could encourage and support the establishment of farmers’ cooperatives and industrial associations or federations according to law. For example, financial support and tax incentives could be provided for these organisations. In this process, the cultivation of local talents in rural areas is particularly important. The government can give a hand to rural entrepreneurs to start their own businesses.

3. Market-oriented public services provided by local government could be strengthened

Local governments could provide more market-oriented public services for smallholders and new business entities. (1) At the production level, policy support should be provided for production facilities, technical equipment, small loans, agricultural insurance, and other guarantees. (2) At the market service level, guidance and assistance should be offered for market entities in the aspects of brand building, quality certification and the industrial integration of regional agriculture. (3) At the training level, training resources and innovative training methods should be integrated, and there should be an emphasis on training to support rural digital industries. For example, training could cover e-commerce sales, brand building and promotion, online live broadcasts, and other aspects to encourage the cultivation of new forms of rural business.

In addition, to promote the development of contract farming in the Mekong River Basin, the government could establish a regional agricultural product market system and share market interests: this could result in mutual benefit through means like investment and cooperation.

Introduction

At present, and for a long time to come, the family management of small farmer households has been the main form of operation for Chinese agriculture. In 2019, the added value of China's primary industries accounted for 7.1 percent of its GDP, while that of its secondary and tertiary industries accounted for 39.0 percent and 53.9 percent, respectively (see Figure 1). By the end of 2019, the Chinese population was about 1.4 billion in total, of which the permanent urban population was 84.843 million, accounting for 60.6 percent of the total (see Figure 2). The rural population was 55.62 million, which constituted 39.4 percent. In 2017, cultivated land in China covered 13,4881.2 thousand hectares, thus the per capita cultivated land area was 1.46 mu (unit of area), which was less than the world's per capita cultivated land area (2.89 mu per capita), which means that the operation of small farmer households has been the basic form of Chinese agriculture for a long time.

Figure 1: The percentages of GDP attributable to the three sectors since 2015 in China (%)

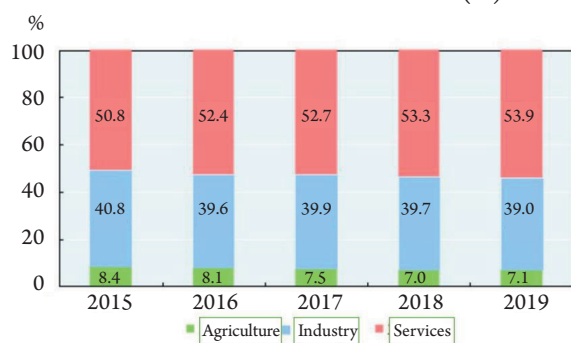


Figure 2: The urbanisation rate from 2015 to 2019 in China (%)

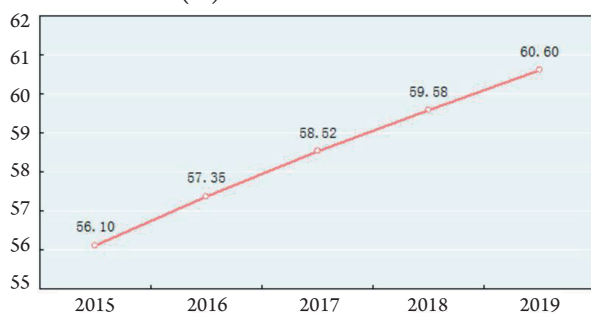
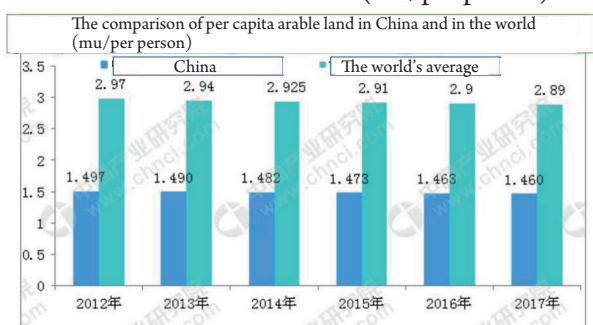


Figure 3: The comparison of per capita arable land in China and in the world (mu/per person)



The modernisation of agriculture and rural areas is inseparable from the modernisation of small farmers. Focusing on supporting and transforming small household farmers is the objective behind the implementation of rural revitalisation and the acceleration of agricultural modernisation. Contract farming is a relational form that realises the connection between small farmers and the market, which helps to organically link with modern agriculture. As a way for small farmers to connect with modern agriculture, contract farming has developed rapidly in China. According to a survey by the Chinese Ministry of Agriculture and Rural Affairs, more than 6,000 hectares of planting area were involved in contract farming in 2016 - a fivefold increase over 2000. In 2017, the number of organisations that participated in agricultural industrialisation was seven times that of 1996 across 31 provinces in China. The proportion of farmers participating in contract farming increased accordingly, from 10 percent to 24 percent.

Contract farming has gradually evolved into a variety of organisational modes in practice, which have reflected the connection between small farmers and different market entities, intermediary organisations, and even the government. Although the organisational types of contract farming vary, in general, there are two types: a production management contract and a market contract. A production management contract means that enterprises control the production process of the farmer households and stipulate a specific production model. Enterprises provide critical inputs in the production process, such as fertilizers, seeds, production tools, facilities, etc. The contributions enterprises offer are equivalent to physical credits, and the cost will be recovered when these products are delivered. In the market contract, enterprises stipulate only the time, place, price and quality of acquisition. Farmers have considerable independent decision-making power in production, but the production process risks are taken by them (Ronald L et al. 1963). Based on the field research of our group, there are three main contract farming modes: the centralised model (company + farmer); the intermediary model (company + cooperative /intermediary + farmer); and the "cooperative + farmer" model which is the mix of the former two modes (Martin Prowse 2012).

Different contract farming models have different characteristics in promoting the income and benefits of small farmers. Various organisational models determine the parts and shares that small farmers can benefit from in the industrial chain. At present, there are two different views on whether, and by how much, small farmers can benefit from contract farming. Most scholars believe that contract farming can increase the income of small farmers, but some think that small farmers actually cannot benefit much from it. Scholars with positive attitudes hold

that contract farming provides convenience for small farmers in terms of production technology, market sales, and organisational level, to increase their income and improve their capacity (Gatto et al. 2017; Bolwig et al. 2009; Liu Xiaou and Di Yuan 2013). However, scholars with negative attitudes believe that contract farming increases the exploitation of small farmers by enterprises. To reduce transaction costs, companies prefer to sign orders with larger farmers, excluding the vulnerable ones with small production scales (Xu Jian and Wang Xuhui 2011). The high investment in contract farming will increase the burden on farmers to some extent.

Furthermore, because of the provision of standardised technical services in the production process, farmers lose the ownership and choice of crops in their agricultural production, thus becoming a “worker” of the company. The imbalance of power between farmers and enterprises keeps farmers in a marginal position in the participation process. In the chain of interests, farmers do not share the profits brought about by the reduction of transaction costs, so they are still at the lowest level in profit distribution. Furthermore, to a certain extent, contract farming destroys the diversification of the local economy (Bellemare 2018).

Therefore, this research analyses the benefit mechanisms and conditions of small farmers in different types of contract-farming arrangements. It also explains the factors that determine the success or failure of contract farming through field research. This study proposes policy suggestions to promote the development of contract farming and the sustainable benefit to small farm households.

The Key Findings

1. In the “company + small farmers” model, small farmers acquire the essential benefits of land and labour value, and they can improve the value through advancements in crop and technical training. In this model, the scale of small farmers’ land and the information symmetry between small farmers and companies are critical factors in the participation of smallholders.

2. In the model of “company + intermediary organisation + small farmers”, small farmers obtain a value-added premium share in addition to basic income through an organised form. In this model, the benefit share of small farmers depends on the degree of organisation and the depth of their participation.

3. In the model of “cooperatives + small farmers”, product innovation and membership are the way to benefit small farmers. They obtain basic income, a value-added premium, and dividend income through order contracts, dividend contracts and employment, thus realising multi-channel acquisition and creating revenue in the value chain. In this model, the benefit to small farmers depends on how closely the small farmers and the cooperatives are connected.

4. Factors that lead to the successful operation of contract farming include:

- Attributes of agricultural products. For seasonal agricultural products that are difficult to store, such as vegetables and fruits, farmers are willing to sign sales contracts to ensure sales and obtain a stable income. Agricultural products that are easy to store, such as rice, farmers tend to sell themselves.
- Characteristics of companies or cooperatives. According to the results of the field research, there is a base for mutual trust between local companies or cooperatives and farmers. As a result, companies or cooperatives can make the most of the network of acquaintances in the local society to realise the effective “embedding” of economic and social benefits, thus creating conditions for the development of contract farming. The management and control capabilities of companies or cooperatives are also among the important factors determining the quality of agricultural products.
- Government support. Government support for contract farming, especially in the construction of technology, information and market environments, has promoted the development of contract farming.

5. Both formal and informal models dealing with breaches of contract are found in this study. Formal means include the deduction of a deposit according to the contract, or requesting farmers to pay the company’s early expenses relating to seed, fertiliser, and other agricultural materials according to the market price. Informal means include verbal warnings, acquaintance persuasion, or leaving the issue unaddressed.

Table1: Comparison of three models

Model	Contractee	Contractor	Contract document	Benefits of smallholders
Centralised model	Firm	Smallholders	Formal document	Higher price technology learning
Intermediary model	E-commerce firm	Middle man	Formal and verbal	Higher price
Farming cooperative plus farmers	Farmer professional cooperative	Smallholders	Formal and verbal	Higher price technology learning membership benefits

Policy Implications

First, the construction of a trust-oriented social relationship between big companies and small farmers still needs to be improved. The realistic basis for the effective operation of contract farming is that companies, cooperatives and farmers share a good basis for social trust. However, the field research results show that farmers are not willing to sign long-term contracts with companies. One reason is that farmers lack the ability to understand and sign a formal contract due to their low level of education. Another reason is that there is a lack of social trust between a big company and small farmers. In contrast to the formal contract led by a big company, farmers have much more trust in their acquaintances in rural society. This is characteristic of rural communities, in which farmers build up social relationships and share rural culture based on geo-relations and kinship. So, when companies and small farmers lack the confidence to invest in the future market, both of them are likely to make short-term deals rather than long-term ones, even though they fail to enter into a contractual relationship. Therefore, in the initial stages of cooperation between the parties, the grassroots government, including village committees, can act as a "bridge" between companies and farmers. The government could consider intervening in an appropriate way to promote the establishment of the social relationship between big companies and small farmers.

Second, farmers' ability for self-organisation could be enhanced. Smallholder farmers often lack marketing and bargaining power when working with large companies. Even if a third party is placed between the company and the farmer, the interests of the farmer may not be guaranteed. Thus, improving the organisational capacity of small farmers can strengthen their power in product standards, pricing and other aspects, enhancing their ability to acquire value in the value chain. Farmers need organisations that can negotiate on an equal footing with enterprises. Otherwise, it is difficult to guarantee that the interests of farmers will be respected, and the cooperative relationship between the two parties is unlikely to be stable and sustainable. Therefore, local government, particularly the Bureau of Agriculture and Rural Development, must increase the cultivation of, and support for cooperative organisations in rural locations. To support cooperation among small farmers in the same areas and growing the same crops, local government can encourage and support the establishment of farmers' cooperatives and industrial associations or federations according to law. For example, financial support and tax incentives could be offered to these organisations. In this process, the cultivation of local talent in rural areas is

particularly important. The government can give a hand to rural entrepreneurs to start their own businesses.

Third, market-oriented public services provided by local government could be strengthened. Local governments could provide more market-oriented public services for smallholders and new business entities. (1) At the production level, policy support should be provided for production facilities, technical equipment, small loans, agricultural insurance and other guarantees. (2) At the market service level, guidance and assistance should be offered for market entities in the aspects of brand building, quality certification and the industrial integration of regional agriculture. (3) At the training level, training resources and innovative training methods should be integrated, and emphasis placed on the training of rural digital industries. For example, training can be conducted in e-commerce sales, brand building and promotion, online live broadcasts, and other aspects, to encourage the cultivation of new forms of rural business.

In addition, to promote the development of contract farming in the Lancang-Mekong River Basin, the government could establish a regional agricultural product market system, share market interests, and achieve mutual benefits through means such as investment and cooperation.

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