Smallholder production agreements in the Lao PDR: qualifying success – *Briefing*

By David Fullbrook
Produced by Laos Extension for Agriculture Project (LEAP) for the Government-Donor Sub-working Group on Farmers and Agribusiness

Background

Smallholder farmers in the Lao People’s Democratic Republic, or Laos, are experiencing great change which brings opportunities but also challenges. Agribusiness can enhance livelihoods, improve well-being, and strengthen resilience of local communities and the nation. However, agribusiness has not always gone well for farmers.

Farmers experience of success in agribusiness may help overcome problems elsewhere. In 2011 field research examined 12 cases for issues and success factors. The context of policy, agencies and trade was also analyzed. Findings were published in a study report “Smallholder production agreements in the Lao PDR: qualifying success” which is summarized in this briefing.

Elements of successful production agreements

Factors internal to agreements
- Written production agreements
- Pricing by recognized benchmark market
- Advance payments
- Certified production systems e.g. FairTrade, Organic

Factors external to agreements
- Relationship value/social ties and interests
- Facilitators
- Highly complementary production/consumption
- Market information

Prospects for successful outcomes may be correlated with the presence of more factors, some of which are amenable to support by policy and programmes which are the subject of extensive recommendations.

Role of local line agencies including DAFO

It is common for local line agencies, including the District Agriculture and Forestry Office (DAFO), to try to achieve policy goals by attempting to direct economic activity, whereas farmers and investors in a semi-market economy look to prices and market access for direction.

To remain relevant, be valued by farmers and support national economic development local line agencies require enhancement to realign their roles and responsibilities to providing supporting services within the realities of budgets, staff and capacities.

Agencies will be more effective if they focus intensely on doing a few things well rather than trying to do everything, amid clear divisions of authority, jurisdiction and responsibility.
Context and trends (Section 7)

Context

Economy

Rapid growth and transformation as investment in agricultural commodities, minerals and hydropower transforms the landscape, natural flows, and access rights.

Market proximity

Experience suggests agricultural products from Laos are less valued in Thailand and more valued in China. Laos is too similar to Thailand, whereas it is highly complementary to China, especially the temperate north. Laos has a strong comparative advantage vis-à-vis China.

Agribusiness competition

Agricultural exports are rising from neighbours of Laos which suggests Laos should pay careful attention to its comparative advantages.

China’s interests

China’s periphery policy aims to develop cordial ties with neighbours and support their prosperity through investment, aid and favourable trade regimes. Laos will continue to receive a lot of attention from China and its investors, especially in energy, minerals and materials.

Trends

Information and communication

Mobile telephone and data services are expanding rapidly in Laos. Farmers increasingly access market information and work with investors locally and transnationally via telephone. Production in Laos is increasingly connected by road and exposed to regional and global demand and price transmission.

Shifts in production and security

Globally, food demand and resource intensity are rising, land, water and energy stress is worsening. Laotian smallholders comparative advantage in producing sustainable food and materials is complementary to land-squeezed China and Vietnam, but not land-rich Thailand.

China agricultural challenges

Agriculture is affected by urbanization, pollution, desertification and aquifer depletion.

China qualitative change

Chinese consumers are becoming wealthier and more urbanized. They are demanding better quality products and more meat, which China’s farmers struggle to meet. Demand is already spilling over the border into northern Laos.

Implications

- Exploiting opportunities in change, context and trends requires future-oriented policies, programmes and agencies
- Smallholder farmers in Laos live and work in times of great change
- Food and other smallholder products are increasingly valuable in the age of scarcity
- Smallholder farming can be sustainable, resilient, and ready for future climate stress, but requires support to transfer knowledge and develop skills
- Support must help farmers sustainably produce higher-value crops for wealthier urban markets in China, maybe Vietnam
- Forming robust links with those markets faces challenges of distance, language, knowledge, technology and trade regimes
- Production agreements can help develop and secure opportunities with investors who provide access to urban markets
- Investors interests, capabilities and capital are compatible with long-term relationships with smallholder farmers
Commercial production agreements between smallholder farmers and investors in the market economy exist within a dynamic web of issues which interact and influence in complex ways which may not always be apparent or present or consistent.
Cases: findings and interpretations (Section 8)

CASE 1 Facilitators
Facilitators can connect farmers to distant niche markets for higher incomes
- Equitable, quality production is rewarded with higher prices from concerned consumers in developed countries
- Preference for secure supply favours long-term relationships and production agreements
- Intermediaries can provide information to facilitate bargains between parties separated by distance and ignorance
- Technical assistance can help establish certifiable equitable production systems

CASE 2 Land incentives
Screening farmers and offering land may lead to better farmer performance
- Confidence and understanding between farmers and investors takes time
- Production volumes may be supported by selecting farmers with good reputations
- Land provision can be an incentive for farmers to enter agreements
- Investors may only work with farmers when they cannot gain direct control of land
- State enterprises may enter agreements for commercial and policy reasons

CASE 3 Investor reliability
A reliable investor providing close support can help farmers secure better incomes
- Amiable respectful staff improve investor relationships with farmers
- Farmers’ interest in an agreement strengthens when they are confident it will endure and continue to deliver benefits
- Farmers appetite for higher open market returns can wane when investors are dependable
- Investor is a reliable buyer

CASE 4 Cartels and benefits
Local investors may act as cartels but this may be the price of providing reliability and credit services to farmers
- Social interests and reputation may discipline local investors
- Networks of representatives who know farmers well can help achieve scale efficiencies
- Production agreements may be key for cartels to earn higher returns which support their provision of social benefits
- Farmers dislike risks of accepting inputs on credit under production agreements

CASE 5 Sustainability
Intensity of production under agreements may exceed ecological sustainability posing long-term risks to livelihoods
- Production agreement successful, farmers enthusiastic
- Yields peaked then fell despite additional fertilizer and crop rotations
- Production agreements do not harmonize methods with ecological conditions
- DAFO’s focus on investors may deliver more immediate benefits, including higher production by mobilizing capital, relative to its limited resources

CASE 6 Bonded investment
Performance-assurance bonds can screen out weak investors
- DAFO can provide production opportunity information to investors
- DAFO can support negotiations when requested by farmers and investors
- Bonds may deter weak investors and build confidence with farmers
- Bonds are a tool for economic enforcement of investor commitments
- Upfront payments for land use show investor commitment, build confidence with farmers
Cases: findings and interpretations (Section 8)

CASE 7 Commercial facilitators
Kin ties facilitate trans-national production for distant markets
- Family and kinship foster transnational agreements without line agencies
- Production agreements can be initiated by commercial facilitators
- Laotian farmers can produce products for sale to long-distance fresh markets
- Opportunities for Laotian farmers and Chinese investors may grow because the tropical seasons and conditions of Laos are complementary to semi-arid northern China

CASE 8 Beyond agency limits
Farmers and investors avoid costly rules and regulations
- Farmers and investors perceive little value in the services of state agencies
- State agencies generate transaction costs farmers and investors try to avoid
- Investors can find it cheaper to ignore local line agencies and deal only with customs
- Farmers and investors often make agreements without involving state agencies

CASE 9 Information and risks
Informed farmers can negotiate better bargains with investors despite shortcomings of DAFO
- Farmers can acquire information
- Farmers reduce risk by sending unknown investors to DAFO
- DAFO could provide assessments to match crop varieties and cultivation methods with local conditions to maximize output
- DAFO lacks the capacity to manage trade-offs between food security, poverty reduction and investor interests

CASE 10 Investor competition
Fraternal networks facilitate trans-national production with foreign investors
- Social ties support agreements between Chinese investors and Laotian farmers
- DAFO can be counterproductive for farmers and investors from China
- DAFO’s preferred investors offer worse terms than private investors for farmers
- Demand and competition from China is favourable to farmers in Laos and better production agreements

CASE 11 Investors and traders
Farmers improve livelihood security and reduce risks by splitting production between investors and traders
- Competition supports better terms in production agreements for farmers
- Interest-free credit builds confidence and compensates farmers if investors fail
- Farmers supply crops to investors and traders to promote competition and insure against buyer failure
- DAFO introduces uncompetitive investors to farmers

CASE 12 Reputation matters
DAFO cannot obtain compensation when a promoted investor abandons farmers
- Picking investors is risky because of uncertainties over quality or intentions
- DAFO risks reputation by introducing investors to farmers
- Farmers and investors are likely to shun DAFO if its reputation is poor
- Laotian production will be compelling for investors if the variety is uncommon in China and the quality is high
Success factors (Section 9)

Internal

- Written agreements (cases 1, 3, 4, 5, 6, 7, 9)
  A mechanism for transparency, certainty and confidence

- Market price (cases 4, 11)
  Specified in an agreement as the benchmark which provides the best 'independent' price locally, sometimes subject to a floor price

- Advance payments
  Demonstrates investor commitment and if investor fails provides compensation for farmers who in turn may feel greater duty to perform
  - Land-use fees (cases 6, 9)
  - Universal interest-free credit (cases 4, 11)
  - Bonded investment (cases 6, 10)

- Certified production (case 1)
  Assures buyers of production quality and terms which can earn higher prices in some markets

External

- Relationships and social interests (cases 1, 2, 3, 4, 5, 7, 10)
  Relationships take time and benefit from social ties and reputation concerns

- Facilitators (cases 1, 7, 8, 10)
  Bridge gaps to lubricate agreements between investors and farmers for social or commercial reasons

- Market information (cases 1, 5, 7, 9, 10)
  Helps farmers make better decisions and negotiate fairer agreements with investors

- Balancing traders and investors (cases 1, 11)
  Farmers split production between investors and traders to improve terms

- DAFO support (case 6)
  DAFO matches crops to local conditions and requires bonds to deter weak investors

Enforcement

Means

- Economic (cases 4, 10, 11)
  Understanding, reputation and a good return gives farmers and investors a strong interest in an agreement even when problems arise

- Social (cases 4, 7, 9, 10)
  Extended family ties, social standing, and other relationships give farmers and investors from the same community reason to perform

- Administrative (cases 6, 8, 10, 12)
  Recorded – e.g. bonded investment
  Expected – e.g. DAFO/kumban mediation

- Legal
  Embryonic legal system is inaccessible

Efficacy

- Economic and social means are simplest and most effective

- Administrative and legal means are complicated, ill-defined, inconsistent, under-resourced and at risk of bias
Analysis (Section 10)

Assets

Financial capital (cases 1, 4, 11)
- Farmers cite lack of capital for not investing in production
- Crops used as collateral or discounted for credit from traders
- Investors supply inputs on credit transferring cost of production risks such as weather to farmers
- Investors often supply inputs or credit interest-free
- Production agreement credit offsets investor risk for farmers
- Credit can build trust, confidence

Land (cases 2, 6)
- Some investors may value land more than farmers
- Some investors may ownership of farmers’ land
- Creditors may cancel debts in exchange for land

Information (cases 5, 6, 7, 9)
- Information poverty common
- Local and regional prices would help farmers negotiate
- Farmers also need to know why prices are moving

Structure

Market prices (cases 4, 11)
- Investors look to a local market benchmark but farmers see transnational prices from spot traders
- Better communications allow markets to expand, increasing competition
- Dynamic context could squeeze local investors and reduce the capital and social services they provide

Monopsonies (cases 4, 7)
- Local line agencies select investors
- Investors may need monopsonic profits to supply credit, sustain operations
- Competition may produce better prices but raise risks and reduce services

Asymmetry (cases 3, 9, 10)
- Farmers risk a bad deal when investors, facilitators, officials enjoy information and power asymmetry

Dependency (cases 3, 9)
- Farmers may have dependency relationships with DAFO or investors because of risk aversion and information asymmetry

Misalignments and intentions

Misalignments of policy with interests of farmers undermine long-term potential and support higher transaction costs with implications for ecological sustainability of production, smallholder farmers prosperity, and investor returns.

Misalignments
1. Production intensity facilitated by agreements may exceed ecological sustainability
2. Farmers often aim to invest in open market-production while policy emphasizes production agreements
3. Budget and capacity are insufficient for local line agencies to work closely and extensively with farmers, thus focusing on a few investors may appear to offer better prospects of raising output to meet policy goals (this does not mean large corporate farms are more productive than smallholders) (cases 4, 5)

 Farmers access limitations
- Financial capital e.g. savings, credit, insurance
- Knowledge capital
- Land rights
- Market information
Role of Local Line Agencies (Section 11)

The study examined the role specifically of DAFO. However, as several line agencies either have discrete responsibilities which include aspects of smallholder agribusiness or have responsibilities which overlap and compete with DAFO the findings to varying degrees may also apply to local line agencies in general.

### Assessment

- Roles, duties and responsibilities for supporting farmers and production agreements are highly fragmented and poorly coordinated
- Some officials are making considerable efforts under difficult circumstances, not least insufficient budgets and capacities, to support production agreements
- Many officials still think their duty is to coordinate and organize production, a function performed by the market
- Investors and farmers are increasingly able to provide many of the functions previously supplied by extension services
- Legacy ideas of coordination and control plus budget constraints can lead agencies to work closely with investors, who provide operating funds, at risk of goal confusion, capture, and rent seeking

### Support recommendations

- Leverage the strengths of DAFO – staff size, familiarity with farmers and local conditions
- DAFO’s role to support and protect smallholder farmers requires public clarification and definition
- Line agencies require close oversight to ensure they adhere to government objectives and are not compromised by investors
- Focus agency assets clearly away from coordination and control to supplying enabling services such as agreement advisory, negotiation support, ecosystem maintenance management, and mediation
- Develop tools and guidelines for staff to assess and advise on production agreements if they are presented by farmers and investors for review

### Roles for DAFO

- Supplying regional and international prices and trends
- Offer farmers training on negotiation, drafting production agreements
- Function as an honest broker if requested by farmers and investors
- Supporting but not controlling farmer production organizations
- Developing a fair business environment with standardized procedures and regulations to attract quality investors
- Administer bonded investment to deter weak investors
## Recommendations (Section 12)

### General

1. Reward and penalize officials based in part on feedback from farmers and investors
2. Clearly define responsibilities and jurisdictions of agencies (case 8)
3. Develop a quality business environment to attract quality investors (case 6)
4. Develop role of community service providers, including farmer associations, to support agribusiness
5. Standardize agricultural business and trade across all districts and provinces (case 10)
6. Improve efficiency by organizing agencies around production zones instead of by district and provincial boundaries
7. **Align policies, programmes and roles to changing context and major trends for a strong position in the future**

### Development partners

1. Support research and piloting of community environmental sustainability management capacity including training farmers, officials and investors (case 5)
2. Support development of sustainable agricultural practises, including agro-ecological methods, drawing on experiences in other countries and provide training to farmers and officials
3. Develop and support farmer business schools (cases 3, 4, 5, 7, 9, 10, 12)
4. Support development of farmer market information and news services using mobile communications to reduce information asymmetry (cases 4, 5, 7, 9, 10, 12)

### Enterprise environment

1. Supply detailed information on local agricultural characteristics and crop suitability (cases 5, 6)
2. Restrict arbitration and support services to farmers and investors using clear and equitable model agreements
3. Require investors to lodge performance bonds to deter weak investors (case 6)
4. Establish transparent, equitable and affordable arbitration in the community (case 8)
5. Help farmers improve output by improving knowledge/skill capital to substitute for financial capital such as credit
6. Establish insurance schemes to reduce farmer risk exposure, especially for credit

### Agricultural sustainability

1. Inform farmers and investors of characteristics and thresholds of agro-ecological zones
2. Enable communities to undertake maintenance of ecosystem services (case 5)
3. **Strengthen farmers resilience and national food security by introducing environmental sustainable agricultural practises, including agro-ecological methods and experiences**
Focus Sustainability (case 5 & section 10)

Falling yields under production agreements suggest the land was unable to cope with higher intensity farming. (case 5)

Hypothesis

Semi-subsistence production operates within the threshold of an ecosystem’s sustainable yield because farmers lack capital to intensify cultivation.

Production can exceed the sustainability threshold when capital disrupts the equilibrium to intensify production. Yields and incomes rise and then fall as ecosystem assets such as soil decline.

Outcome

Mobile investors and capital move on but immobile farmers suffer damaged ecosystems.

Explanation

Increased capital enables production to intensify use of ecosystem stocks and flows which exceed regeneration limits leading to decline because no group or agency is responsible for maintenance.

Solution

Institutions, such as production agreements, must explicitly recognize sustainability and adjust crops and production techniques to match the market with the limits of the ecosystem.