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CONTRACT FARMING SYSTEM: A TOOL TO TRANSFORMING RURAL SOCIETY IN SABAH.

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1.0 Introduction

Recent decades have seen major change in agricultural technologies as a consequence to various programs for an agricultural development in rural areas of Sabah. Villagers in Sabah have always been receptive to new agricultural technologies that promises to improve their standard of living and as a reflection from the promotion of new agricultural technologies, many peoples in rural areas in Sabah now working with a mix of traditional and modern technologies. Along with the adoption of modern technologies, there has been a rapid transformation to cash economy among rural areas in Sabah (Marten, 1990).

However, most villagers in Sabah are still produce almost entirely for home consumption, although the other economic activity of rural peoples in Sabah is small-enterprises as well as “*kedai kampung*” or rural shop that is registered under the local registration authority. This means, meeting basic household food needs is still the priority of most farmers in Sabah. Most also produced as much as surplus as possible to meet cash needs generated by expanding public education, rural electrification, modern communication (e.g. Radio and Television), and modern transport. It confirmed that most rural societies in Sabah still run their subsistence agricultural economy as compared to cash economy, which generally in farm activities, men do the major task and the women do the very minor task.

Alongside with the fact that in this post-modern world most rural society in Sabah involved in agricultural economy, rural population especially among youth has declined. This means that human force for agricultural sector is declined as well. Rural population in Sabah was declining due to migration of younger-age groups. Outward migration among them was caused by the economic purposes such as to find non-agricultural financial resources (work in government sector either in the white or blue collar works). As according to Bryden (2000) villagers often migrated because the trend in agricultural income that is reported as lower than income from other economic activities. Some of them were migrated to the urban areas when they employed as the non-government professional executive level and further their education. Some other (female) moved to follow husband.

In short, they were migrated because of work-related reason and to get social fulfillment in the form of further education, social amenities and the family reason. This phenomenon in the future, out migration of youth will leave the youngsters and old folks to maintain the village and at the end, population of rural areas in Sabah will be increasingly independent. Village-base economy especially agricultural production will suffer when the active youth have left for the town. In the other hand, rural

poverty profile that is currently high will be increased. Hence, commercialization of agricultural sectors in rural areas assumed as the best resolution to improve villager's standard of living that is bring about transformation of rural agrarian society from the traditional society to modern agrarian society through contract farming system.

2.0 Contract Farming System

A farming system is often referred as a group of farmer households operating in a more or less homogenous agro-ecological setting that have similar socioeconomic characteristics and comparable resources endowments as well as similar constrains and opportunities for development (Topouzis, 1995). According to Ratanawaraha (1982) new or modern farming system, which characterized by the sustainable concept represents a variety of agricultural system including integrated farm, organic farm, natural farm, and agro forestry and contract farm? Among these farming systems, contract-farming system is considered as the most suited to improve smallholder's standard of living. This farming system has been promoted over the last three decades as an institutional innovation to improve agricultural performance in less developed countries sometimes as a key element to rural development and/or settlement projects (Rehber, 2000; Ghee and Doral, 1992).

Contract farming system as pointed by Bauman (1997) is refers to a system were a central processing or exporting unit purchases the harvests of independent farmers and the purchase are arranged in advance through contract. The terms of contract vary and usually specify how much produce the contractor will buy and what price they will pay for it. The contractor frequently provides credit inputs and technical advice. 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. In short, contract farming is the means by which risk is distributed between the out grower and the contractor.

The system, in theory, has potential advantages for both sellers and buyers (Grossman, 1998). Farmers benefits from a generated market, which reduce the uncertainty associated with wide fluctuations in demand characteristics of open markets. Although method of price determination vary considerably, price stability is also normally greater in contract farming. Substantial advantages also accrue to buyers. The riskiest and least profitable stage of the commodity chain is left to farmers and the threat of expropriation is neglected (Goldsmith, 1985). Contracting provides a more regular and dependable supply for processing, marketing, and exporting than open market purchases. Contract farmers are more highly motivated to produce high-quality output than a company's own plantation labor force, as the price farmers received depend on the quality of their output. Contracting gives buyers more control over the production process than they have in open market relations, as contract usually specify the procedures to follow in the cultivation and harvesting.

Although contract-farming schemes can be included farms of almost any size, from peasant micro plots to thousand-acre plantations (Watts *et al.*, 1988). Reason for their involvement vary considerably often according to whatever capital or the state is the dominant force behind initiating and managing the system. Peasant can also produce under conditions that are unprofitable for larger enterprise for; (1) they grow some of the food that they consume by also engaging in subsistence cultivation (the

classic ‘subsidy’ to capital), and thus do not have to rely exclusively on returns from contract production to survive; and (2) they exhibit the well-known capacity for “self-exploration” of household labor (Clapp, 1994).

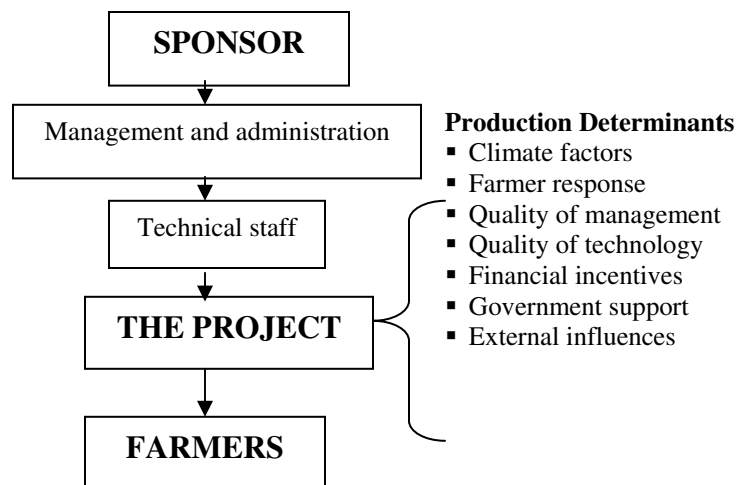
Indeed, state presence and influence in these schemes is considerable, with projects managed by statutory corporation and public-private venture being widespread (Glover, 1984). Glover and Lim (1982) recited that contract farm as it is generally connotes a private sector scheme have become widespread in Asia and other parts of the developing world over the last ten years. Glover and Lim (1982) state that the actual practice of contract farming system is more complex than the simple definition given since there are many variation of different aspects of the contract. Moreover, this system involves a contractual relationship between farmers and a control processing or exporting unit. That unit can be a private firm, a public agency or a joint venture of several types.

Contract farming system therefore has its various types based on the model being adopted. Types of contract farming are including centralized model, nucleus estate model, multipartite model, informal model and intermediary model.

1. The Centralized Model

This is a vertical coordination where the sponsor purchases the crop from farmers and processes or packages and markets the products (Figure 1). Except in a limited number of cases, farmer quotas are normally distributed at the beginning of each growing season and quality is tightly controlled (Eaton and Shepherd, 2001). A sponsor may purchase from tens thousands of small-scale farmers within a single project. The centralized scheme is generally associated with tobacco, cotton, sugar cane and bananas and with tree crops such as coffee, tea, cocoa and rubber, but can also be used for poultry, pork and dairy production. Where fresh vegetables and fruits grown under contract, the term “processing” may includes grading, sorting and packaging as well as the provision of cool storage facilities.

Figure 1: The Centralized Model



Source: Eaton, C. S. (1998)

In Africa, the contracting out of crops to farmers under centralized structures is common. These are often called “out-growers” schemes (Jackson and Cheater, 1994). For examples, in Zambia the multinational corporation, Lonhro, considered the system preferable to growing cotton on a plantation basis. In the late 1980s it initiated a smallholder project where over 15,000 farmers grew cotton under contract for the company’s ginnery (Springfellow, 1996). The level of involvement of the sponsor in production can vary from a minimum where, perhaps, only the correct types of seed is provided, to the opposite extreme where the company provides land preparation, seedlings, agrochemicals and even harvesting services. The extent of the sponsor’s involvement in production is rarely fixed and may depend on its requirements at a particular time or its financial circumstances.

2. The Nucleus Estate Model

Nucleus estates are a variation of the centralized model. In this case the sponsor of the project also owns and manages an estate plantation, which is usually close to the processing plant. According to Golver and Kusterer (1990), the estate is often fairly large in order to provide some guarantee of throughput for the plant, but on occasion it can be relatively small, primarily serving as a trial and demonstration farm. The British-based Commonwealth Development Corporation (CDC) was a pioneer of the nucleus estate model although it no longer develops such estates. A common approach is for the sponsors to commence with a pilot estate then, after a trial period, introduce to farmers (sometimes called “satellite” growers) the technology and management techniques of the particular crops (Eaton and Shepherd, 2001). Nucleus estates have often been used in connection with resettlement or transmigration schemes, such as in Indonesia and Papua New Guinea, for oil palm and other crops. While mainly used for tree crops, there are examples of the nucleus estate concept with other products. Indonesia, for example, has seen the operation of dairy nucleus estates, with the central estate being primarily used for the rearing of “parent stock”.

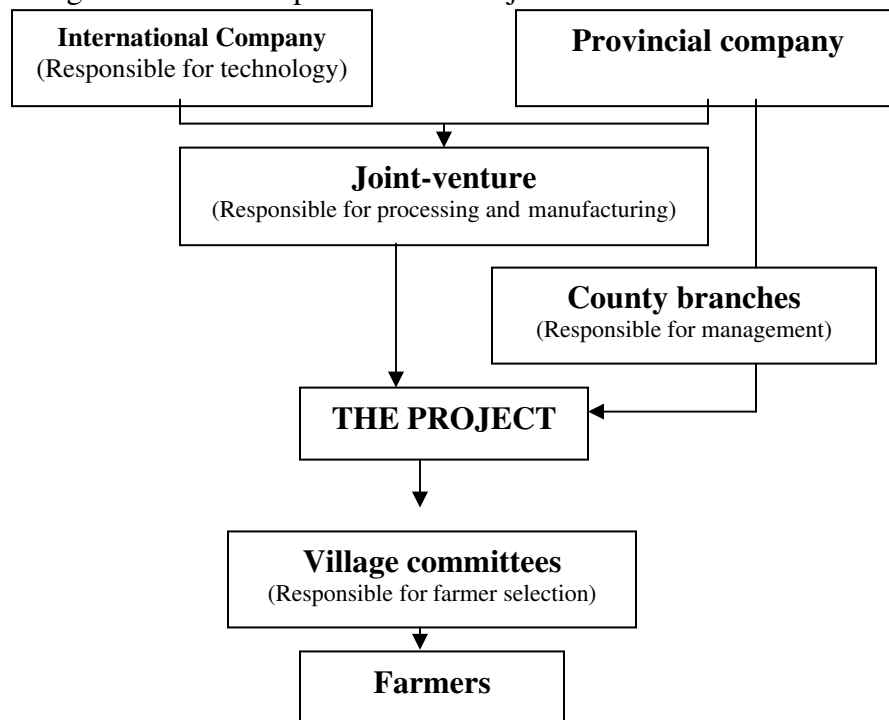
3. The Multipartite Model

The multipartite model usually involves statutory bodies and private companies jointly participating with farmers. Multipartite contract farming may have separate organizations responsible for credit provision, production, management, and processing and marketing. In Mexico, Kenya and West Africa, among other countries, governments have directly instead in contract farming through joint ventures with the private sectors (Little and Watts, 1994). Multipartite structures are common in China where government departments as well as township committees and, at time, foreign company have jointly entered into contract with village committees and, since the early 1980s, individual farmers.

Figure 2 outlines a multipartite model. In this particular case, the county branches, through their agronomists and field technicians, were responsible for implementing and maintaining the terms and specifications of the agreement. There were formal contracts between the joint venture and the branches, and written contracts between the counties and the village committees, but only a verbal understanding between farmers and their respective committees.

Eaton (1998) recited that in theory; farmers were expected to carry out cultivation as specified by the joint venture. In practice, however, county officials only followed instructions from the joint venture if to do so was in county branch's immediate economic interest, irrespective of quality standards and long-term production objectives. The lack of coordination between the joint venture and the county management, village cadres and farmers eventually resulted in the collapse of the venture.

Figure 2: The Multipartite Model-A joint Venture Contract farming



Source: Eaton, C. S. (1998)

In Colombia, a company started buying passion fruit in 1987 using the centralized model (Dolinsky, 1992). The company ran into difficulties, however, because it proved impossible to control extra-contractual marketing it therefore developed multipartite model in which all farmers were expected to belong to associations or cooperatives and public institutions became involved as providers of credit and extension. This arrangement significantly reduced both the risk of extra-contractual marketing and the company's costs of dealing with individual farmers, while being generally welcomed by farmers. Problems remain, however, most notably in relation to the lack of management skills on the part of the farmer association and cooperatives.

4. The Informal Model

This model applies to individual entrepreneurs or small companies who normally make simple, informal production contracts with farmers on a seasonal basis, particularly for crops such as fresh vegetables, watermelons and tropical fruits

(Shepherd and Farolfi, 1999; Dunham, 1995). Crops usually require only a minimal amount of processing. Material inputs are often restricted to the provision of seeds and basic fertilizer, with technical advice limited to grading and quality control matters. Little (1994) recited that a common example of the informal model is where the sponsor, after purchasing the crop, simply grades and packages it for resale to the retail trade. Supermarkets frequently purchase fresh produce through individual developers and in some cases directly from farmers. Financial investment by such developers is usually minimal. This is the most transient and speculative of all contract-farming models, with risk of default by both the promoter and the farmer. Nevertheless, in many developing countries such developers are individual developers (Eaton and shepherd, 2001).

5. The Intermediary (tripartite) Model

Throughout Southeast Asia the formal sub-contracting of crops to intermediaries is a common practice, which in this model, sponsor are included in sub-contracting linkages with farmers to intermediaries. This model also characterized by the possibility of danger that the sponsor loses control of production and quality as well as prices received by farmers (Beamish, 1994; Burch, 1992). In Thailand, large food processing companies and fresh vegetables entrepreneurs purchase crops from individual “collectors” or from farmers committees who have their own informal arrangement with farmers (Panganiban, 1998; Burch, 1994; CRC, 1990). In Indonesia, this practice is widespread and is termed plasma (Arnon, 1981). The use of intermediaries must always be approached with caution because of the danger of sponsors losing control over production and over prices paid to farmers by middleman.

3.0 How CFS May Bring About Rural Quality of Life Improvement

This sort of vertically coordination production relation is not new (Rehber, 1998). Contracts were employed by the Japanese colonial state for sugar production in Taiwan in the period after 1885 and by the USA banana companies in Central America in the early part of twentieth century (Watts, 1994). By late twentieth century, however, in the Western Europe (Barker, 1972), North America and Japan, contract farming became an integral part of food and fiber industry. In advanced capitalist states, it seems that contract farming was widely used by the vegetable canning industry in North America and by the seed industry in the Western Europe in the 1930s and 1940s. Hence, in this post-modern world Contract Farming System in general may bring about rural quality of life as this farming system able to generate income as much as the farmers could obtain based on their effort personally. In the other hand contract farming would be more efficient than other agricultural production such as plantation and certainly politically acceptable. Consequently, well-managed contract farming considered as an effective way to coordinate and promote production and marketing in agriculture.

In accordance to the advantages of contract farming system compared to other farming system, smallholders were entered contract because of the fourth reason as follow:

1. Access to market

2. Access to credit
3. Managing risk
4. Provision of information

4.0 Conclusion

In short, both farmers and sponsors point of view can define contract-farming advantages. Contractual arrangements can provide farmers with the access to production services and credit as well as knowledge of new technology, reduction of risk and uncertainty by pricing arrangements, and the farmers would have the opportunity to diversify into new crops that not possible without the processing and/or marketing facilities provided by the sponsor (firm).

In the sponsoring companies' point of view, contract farming in many cases be more efficient than plantation production, and will be more politically acceptable, give them access to land that would not otherwise be available and the opportunity to organize a reliable supply of products of the desired quality that probably could not be obtained on the open market (Aboi, 2002).

In contrast, the problems associated with the contract farming are company may fail to honor its commitments and the danger of indebtedness if the problems arise, corruption, sponsoring company may be unreliable or exploit a monopoly position (point of view of farmers), farmers may sell their outputs to outsiders or so-called extra contractual marketing, farmers may divert inputs supplied on credit to other purposes, and the interference of the social and cultural obligations, which affecting farming calendar (point of view of sponsors).

However this new type of agricultural production has its greatest potential to bring about potential benefits to smallholders by providing access to new markets and by providing opportunities for employing underutilized resources, particularly labor. In accordance, contract farm can be the most important agenda in developing countries. This means, contract-farming system should be actively promoted and implemented to improve people's standard of living especially farmers in Sabah, Malaysia.

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