

# CONTRACT FARMING IN LAOS: RESPONDING TO A RISING AGRICULTURAL TREND



*Photo: Harvesting maize under annual contracts, Houaphan province (R. Cole)*

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## KEY MESSAGES

This analysis identifies the following most immediate policy recommendations relating to contract farming in Laos:

- Clarify roles and responsibilities and build institutional capacity to manage CF
- Clarify rights and obligations of contract parties (e.g. using contract templates)
- Establish a grievance mechanism for resolving contract disputes

## BACKGROUND

Contract farming (CF) has emerged as a key agricultural production model in Laos, as farming has become more widely commercialised since the 2000s. Although many different types of contract farming can be observed throughout the country, they are most often informal, ad hoc agreements between buyers (e.g. traders, processors and/or exporters) and farmers. CF schemes are common for bulk export commodities such as cassava, tea, coffee, sugar, banana, maize and rubber, which are in high demand in China, Vietnam and Thailand (Ingalls et al. 2018). Because these production trends have expanded quickly in different areas of the country, there is a lag in policy response to regulate and manage CF, to ensure fair outcomes for farmers and investors, and to avoid negative social or environmental consequences of rapid conversion to commodity crops. This discussion note compiles findings and recommendations

from policy reviews and case studies on CF in Laos conducted from 2010-2020, during which contract-based production of agro-commodities has accelerated in many provinces. This note summarises and highlights key issues and concerns raised in these studies, bringing together available knowledge to support the policies of the Investment Promotion Department (IPD) of the Ministry of Planning and Investment and partners.

Recent work by the Department of Policy and Legal Affairs (DoPLA) of the Ministry of Agricultural and Forestry, together with the UN Food and Agriculture Organisation, resulted in a 'Roadmap for Improving the Policy and Legal Framework for Contract Farming Development in Lao PDR' (MAF and FAO 2019). This discussion note aims to complement this existing work in response to changing agricultural practices in Laos, and to support development of sub-legislation on CF that can help to ensure mutually beneficial outcomes for smallholder farmers and investors in the near-term.

### COMMON CONTRACTING PRACTICES, ISSUES AND QUESTIONS

There are several key underlying issues that cut across most of the studies analysed for this brief. The first is the improvised nature of existing contract arrangements. These are very often verbal, or if written, collective agreements between a whole village (or a number of households) and a buyer, which are then held by the village head. The buyers set out what they will provide for farmers (e.g. inputs, credit

and technical advice), and often set a buying price and, in the case of annual crops, timings for collection of the harvest. This approach has become common because it provides a simple solution for establishing production arrangements between buyers and producers that can be adapted to different crops, based on their specific production cycles and market conditions. Table 1 provides generalised examples of contract models for maize and rubber, which are commonly produced under such arrangements in Laos.

Annual crops such as maize are typically produced under an intermediary model, in which traders process and sell farmers' output to a larger entity, such as an industrial feed mill, often in Thailand or Vietnam. Farmers grow the maize using inputs provided by the trader, which they then repay with a portion of the harvest, under what is known locally in Laos as a '2+3' contract (farmers provide land and labour, buyers provide inputs, technical advice and the market). For perennial crops like rubber, contracts are necessarily longer term and adapted to compensate for the lack of income for farmers during the seven-year maturation of the rubber trees. For this reason, rubber investors commonly rent land from farmers and pay them to work on the plantation, or establish a sharecropping scheme whereby farmers receive income from a percentage of the trees they plant when the rubber is ready to tap. Rubber investors often follow this approach with smallholder farmers in addition to having their own plantation, in a nucleus-estate model. In Laos, models in which investors rent land from farmers but manage all other aspects of production are termed '1+4'.



Photo: Farmers wait to deliver cassava to a processor, Luang Prabang province (R. Cole)

**Table 1: Typical contract arrangements for maize and rubber**

Crop	Contract period	Investor	Farmer	CF model <sup>1</sup>	Local term
Maize	Annual: Traders set price at start of season	Provides inputs, technical advice and market	Provides land and labour, returns input costs to investor from harvest	Intermediary contract	'2+3'
Rubber	Multi-year: Often combines concession with land rental, sharecropping	Rents land, provides inputs, hires farmers, sets a sharecrop proportion	Provides land and often wage labour to tend and tap rubber trees	Nucleus-estate / sharecropping	'1+4' <sup>2</sup>

These are practical examples of how investors find ways to work with farmers in different circumstances, and for different crops. There are instances in which these arrangements work well, but a range of risks can also be increased under informal contracts, including:

- *Economic risks such as price crashes, below-market payments or exploitative labour conditions, with nothing to support farmers or investors in the event of contract breach*
- *Environmental risks of monoculture commodity crops, as investors are able to avoid responsibility for impacts such as forest clearance or overuse of chemical inputs*
- *Lack of official registration or records mean that informal CF often operates with minimal government oversight, increasing the difficulty of developing adequate policy responses, including in cases of dispute between contract parties*



Photo: Harvesting tea, Phongsaly province (S. Sapma)

<sup>1</sup> Typology from Eaton and Shepherd (2001).

<sup>2</sup> '1+4' is in practice a land-lease model rather than CF, but often takes hybrid forms when combined with wage labour and sharecropping, as in the example.



Photo: Rubber plantation, Oudomxay (S. Sapma)

## NOTES FROM THE FIELD: EXPERIENCES OF ESTABLISHING CASSAVA CF IN LUANG PRABANG PROVINCE

A field visit in March 2021 by IPD and MRLG provided a practical example of some of the key concerns of farmers, investors and the government about setting up a CF scheme for cassava in Nan district, Luang Prabang province. These are summarised in Table 2.

The starting point for an effective regulatory environment for CF – that supports both farmers and investors – is to address key questions of clarity, such as:

- (i) Who should be responsible for what, between government departments, the private sector and farmers?
- (ii) What should be in contracts, and how to organise them to reflect the rights and obligations of contract parties?
- (iii) What happens when contracts go wrong, and what kinds of grievance mechanisms are needed to solve disputes?

These issues and others feature in Table 3, which summarises recommendations from CF studies in Laos over the past 10 years. These include policy reviews by government researchers and NGOs, as well as academic research and case studies. Recommendations are categorised and ordered according to the frequency with which they are listed from 2010-2020 in the following sources: Fullbrook 2011; Manorom et al. 2011; IISD 2012; NERI 2014; Onphanhdala et al. 2016; IFAD et al. 2016, 2017; NAFRI and IPSARD 2016; 2017; Sylvester 2018; MAF and FAO 2019a, 2019b; NIER 2020.

**Table 2: Setting up a CF model – Perspectives of farmers, investors and local government, Luang Prabang province**

<b>Farmers</b>	<ul style="list-style-type: none"> <li>• Unfamiliar with contract requirements and production techniques</li> <li>• Unsure of government role and relevant documentation processes</li> <li>• Women need an equal role in signing and managing contracts</li> <li>• Some farmers prefer a minimum price guarantee, others want to choose who to sell to, low understanding that investment by the company is factored into the price</li> </ul>
<b>Investors</b>	<ul style="list-style-type: none"> <li>• Could not identify a clear process for registering a CF agreement</li> <li>• Concerns about side-selling due to competition by brokers, farmers’ need for quick payment and inexperience of farmers in contract production</li> <li>• Concerns about insufficient number of participating households, not enough production</li> <li>• Unsure how well farmers understand contract content</li> <li>• Would like government to communicate policy to farmers, provide support in managing supply-demand dynamics, help to ensure against side-selling</li> </ul>
<b>Government</b>	<ul style="list-style-type: none"> <li>• Would like to be involved in the early stage of drafting and/or concluding contracts between parties</li> <li>• Need for government to raise public awareness about importance of contracts</li> <li>• Policies should represent the needs of all parties including investors and farmers</li> </ul>

**Table 3. Consolidated recommendations of contract farming review**

Categories of recommendation	Detail	Frequency recommended
Institutional arrangements, roles/responsibilities	• Clarify roles and responsibilities and improve coordination among government agencies	11
	• Strengthen (especially district) government capacity to manage CF and inform farmers	8
	• Improve monitoring of CF practices, socio-economic and environmental impacts	7
	• Improve research and data collection on CF and agribusiness investment (including in agrocensus, disaggregated by food and non-food crops)	5
	• Cooperate with the Vietnamese Ministry of Agriculture and Rural Development on agricultural development strategy	2
	• Provide transparent and accountable government support services for investors and farmers	1
	• Base CF management on actual production areas (rather than within district boundaries)	1
Contract templates	• Provide simple contract templates with clear definitions, rights and obligations	5
	• Back up contract enforcement with financial incentives and guarantees, such as deposits	2
	• Maintain flexibility and diversity of CF arrangements (including need for, and benefits of informal agreements in some cases) to help farmers and investors coordinate	1
Regulatory frameworks, laws and grievance mechanisms	• Standardise and improve regulatory frameworks and relevant law(s) to support CF	9
	• Establish clear, standard dispute and grievance procedures, ensure awareness of rights	5
	• Provide legal support for contract parties	3
	• Ensure environmental sustainability through regulatory systems	2
Support for agribusiness investment and trade engaged in CF, processing	• Promote development of domestic agribusiness and processing	6
	• Formalise and improve management of cross-border trade and related infrastructure	6
	• Promote CF with preferential credit, input supplies, extension, capacity building for CF negotiation, dispute mediation, etc.	5
	• Clear and transparent business procedures, same-day/one-stop service	3
	• Identify competitive advantages and export markets for CF of agro-commodities	3
	• Provide data and information for investors and farmers to support CF	3
	• Raise awareness about CF benefits and challenges for public and private sector	3
	• Provide space for non-government actors and producer groups to negotiate with investors	2
	• Encourage longer-term CF arrangements with consideration given to environmental sustainability	1
• Improve rural transport infrastructure	1	
Support for farmers	• Training and awareness campaigns, build farmers' capacity to negotiate contracts	4
	• Strengthen capacity of extension service	4
	• Improve clarity of land tenure	1
	• Reduce risks to farmers, especially impacts of debt and chemical pollutants	1
	• Ensure participatory approaches to contracting and regulatory mechanisms	1
	• Provide government-backed credit and input supply services	1
• Target women for training in CF finance and management	1	
Support for farmers' organisations	• Support development and capacity of farmers' organisations	7
	• Exchange lessons and practices with farmers' organisations in other countries	2
	• Provide support for farmers' organisations in contract negotiation and mediation	2
	• Assist farmers' organisations with credit, land access, tax relief, technology etc.	1
	• Support farmers' organisations to access markets	1

**Towards an enabling and inclusive contract farming regulatory framework**

Many of the studies referred to in Table 3 highlight the lack of a dedicated contract farming law and related sub-legislation in Laos. Despite the existence of the 1990 Contract Law (amended in 2008), this is for all types of production and not specific to farming, which has particular production cycles and arrangements for different crops, livestock and other products. Moreover, the balance of power tends to highly favour investors in CF, while individual farmers may lack the means to seek redress for contract breaches, particularly without a formal grievance mechanism. With informal, often verbal, agreements still dominant in Laos, the risk burden to smallholders remains high (NIER 2020). Although there are instances in which informal agreements function well based on trust, contract breach remains common on the part of both farmers and investors.

In the absence of a specific legal framework for CF in Laos, the overall recommendation of this discussion note is a **two-step process**:

- In the short-term, **sub-legislation such as government instructions, guidelines and templates** can be developed and piloted to help establish and strengthen the formalisation of CF
- These interim measures can **assist the long-term process of developing a comprehensive law** under the 'Road-

map' on CF (MAF and FAO 2019), for which piloting sub-legislation can provide an evidence base

Not all recommendations in Table 3 can realistically be supported by interim CF sub-legislation, such as promoting agribusiness, border trade, or increasing support for farmers, which are matters for wider rural development and agricultural policies. However, coordinated efforts among the ministries mandated with governing investments and agriculture – respectively, the Ministry of Planning and Investment and the Ministry of Agriculture and Forestry – can provide a foundation to support **three key aspects**:

- i) Clarifying roles and responsibilities and building capacity to regulate CF**
- ii) Codifying rights and obligations of contract parties in templates, and**
- iii) How to resolve disputes**

CF is likely to keep expanding in Laos as agricultural commercialisation continues and regional demand increases. Development of dedicated CF sub-legislation can help to provide the basis for a more comprehensive future legal framework that underpins the rights of farmers and investors, while also setting out measures to manage and avoid potentially negative social and environmental impacts of commodity crops.



Photo: Written contracts can help protect the rights of smallholder farmers and investors in CF for annual crops, such as maize (Photo: R. Cole)

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