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Current Issues in Agricultural Contracts

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The importance of contractual agreements, a strategy to organize the marketing and production activities of a farm, has increased in the last decades. The objective of this article is to introduce a series of essays that discuss issues related to contractual arrangements such as: market power, legislation, and why farmers adopt contracts.

The term "agricultural contracts" generally refers to agreements between a buyer and a grower that establish the rules for the production and marketing of agricultural products. These agreements are finalized prior to the harvesting period, or before the completion of a production stage in the case of livestock products (MacDonald et al., 2004).

The adoption of contractual agreements—a strategy to organize the marketing and production activities of a farm—is not a recent development. However, the importance of contract farming has substantially increased, especially in the last decades. For instance, the contractual agreements accounted for 40% of the value of U.S. agricultural production in 2011, compared to 28% in 1991, and 12% in 1969 (Hoppe, 2014; MacDonald et al., 2004). Similar trends are observed in developing countries (Simmons et al., 2005; Bellemare, 2011).

The aforementioned increased utilization of contractual agreements has revitalized the interest of scholars and policy makers regarding the consequences of contract use and the potential impacts of government regulation. The present series of articles addresses several of these issues including: market power and growers' protection legislation, the welfare impact of contractual agreements, data collection issues, and growers' incentives to contract.

Articles in this Theme:

Trends in Agricultural Contracts

Economics of Agricultural Contract Grower Protection Legislation

Risk and the Use of Contracts by Vegetable Growers

Contract Farming: What's in it for Farmers in Developing Countries?

The first article, by James MacDonald, summarizes what the U.S. Department of Agriculture's (USDA) Agricultural Management Survey (ARMS) tells us about the use of contracting in U.S. agriculture today. Furthermore, the author discusses how contracting has changed over time, and identifies those markets where contracts and market power interact.

In the second article, Steven Y. Wu and James MacDonald, outline how potential market imperfections and relationship-specific investments interact with imperfect competition in agricultural contracting environments. Subsequently, the authors discuss recent grower protection legislation. They argue that recent attempts by the USDA Grain Inspection, and Stockyard Administration (GIPSA) to decouple competition issues from issues related to fraud or "unfair" practices in the Packers and Stockyard Act, might

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make economic sense in contracting environments that involve multiple market imperfections.

Jack Schieffer and Michael Vassalos examine fresh tomato producers' incentives to participate in contractual agreements in the next article. Their findings indicate that growers view contractual arrangements as a risk management tool. However, growers risk aversion levels had little or no effect on the selection of contracts. Based on these results, the authors conclude that, for the examined scenario, contracts should be viewed more broadly than just a risk-management mechanism.

The final article, by Marc Bellemare, examines the reasons why smallholder farmers might want to participate in contract farming, and whether contract farming makes these farmers better off. The author concludes that participating in contract farming tends to improve growers' welfare. However, we should be cautious when generalizing these results due to a number of technical statistical limitations. The same issues should be taken under consideration when examining potential policy implications of contract farming.

For more information:

Bellemare, M. 2011. "As You Sow, So Shall You Reap: The Welfare Impacts of Contract Farming." *World Development* 40(7): 1418 – 1434.

Hoppe, R. 2014. Structure and Finances of U.S. Farms: Family Farm Report 2014 Edition. USDA, Economic Research Service, EIB 132. Available online: http://www.ers.usda.gov/media/1728096/eib-132.pdf

MacDonald, J., J. Perry, M. Ahearn, D. Banker, W. Chambers, C. Dimitri, N. Key, K. Nelson, and L. Southard. 2004. "Contracts, Markets, and Prices: Organizing the Production and Use of Agricultural Commodities", USDA, Economic Research Service, AER 837, Available online: http://www.ers.usda.gov/publications/aer837/.

Simmons, P., P. Winters, and I. Patrick. 2005. "An Analysis of Contract Farming in East Java, Bali, and Lombok, Indonesia." *Agricultural Economics* 33: 513-525.

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