

Smallholder production agreements in the Lao PDR: Qualifying Success



Produced by the Laos Extension for Agriculture Project (LEAP)
for the Government-Donor Sub Sector Working Group on
Farmers and Agribusiness

By David Fullbrook

October 2011

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Abbreviations & definitions

Chinese	A citizen of the People's Republic of China; languages of China
DOA	Department of Agriculture
DAFO	District Agriculture and Forestry Office
Floor price	A minimum price agreed by parties to a market price production agreement
Fixed price	A set price agreed by parties to a production agreement
Han	The largest ethnic group in China
Investor	Entrepreneur putting financial, physical, or human resources into an agriculture production arrangement, expecting a financial return
Lao	The official language of Laos; largest ethnic group
Laos	Lao People's Democratic Republic
Laotian	Citizens of the Lao People's Democratic Republic
Leu	A Tai people who live in northern Laos and southern Yunnan, China
MAF	Ministry of Agriculture and Forestry
Market price	A price which changes according to demand and supply
NAFES	National Agriculture and Forestry Extension Services
NAFRI	National Agriculture and Forestry Research Institute
PAFES	Provincial Agriculture and Forestry Extension Services
PAFO	Provincial Agriculture and Forestry Office
Smallholder farmers	A farmer actively engaged in managing and working on his or her own land, whether or not titled or officially recognized, of limited size, usually less than three hectares
SWGAB	Sub-Sector working group on farmers and agri-business

1. Executive summary

Commercial production by smallholder farmers working with investors has expanded considerably over the last decade, with support from the government which expects such arrangements to reduce poverty by improving household income. The results have been mixed. Discourse frequently focuses on disappointments, inequity and failure. There are, however, cases of success which are creating the experience and knowledge which can improve policy and shape practises by farmers, investors and agricultural officers.

This inquiry examined cases across the country covering a variety of agriculture products. There are 11 cases which are considered successful and one of failure. Although cases share some elements of success, each presents at least one unique aspect or insight. Taken together the cases present a broad, if splintered, snapshot of commercial activity between farmers and investors. They leave a sense that opportunities are better, sometimes, for farmers closer to the markets of China than they are for farmers elsewhere. Of course distance is relative not only in terms of geography but in terms of the means and efficiency of communication and transportation.

Overall, the inquiry finds that notwithstanding the problems brought to light in this and several other studies there are numerous elements which contribute to success and which could be applied by farmers, investors and policymakers across the country. A successful outcome for a production agreement depends upon a range of factors internal or external to the agreement. Internal factors are written production agreements, market price, advance payments and certified production systems. External factors include valuing relationships, social interests, facilitators, highly complementary production and consumption, and market information. Moreover, not all elements need be present to assure success. If several are present the prospects for success are likely to be reasonable.

The inquiry finds considerable challenges with roles of the District Agriculture and Forestry Office and other agencies but also several opportunities for meaningful reform to effectively support farmers and agricultural development, provide better value for the government's resource, and more meaningful and rewarding positions for staff.

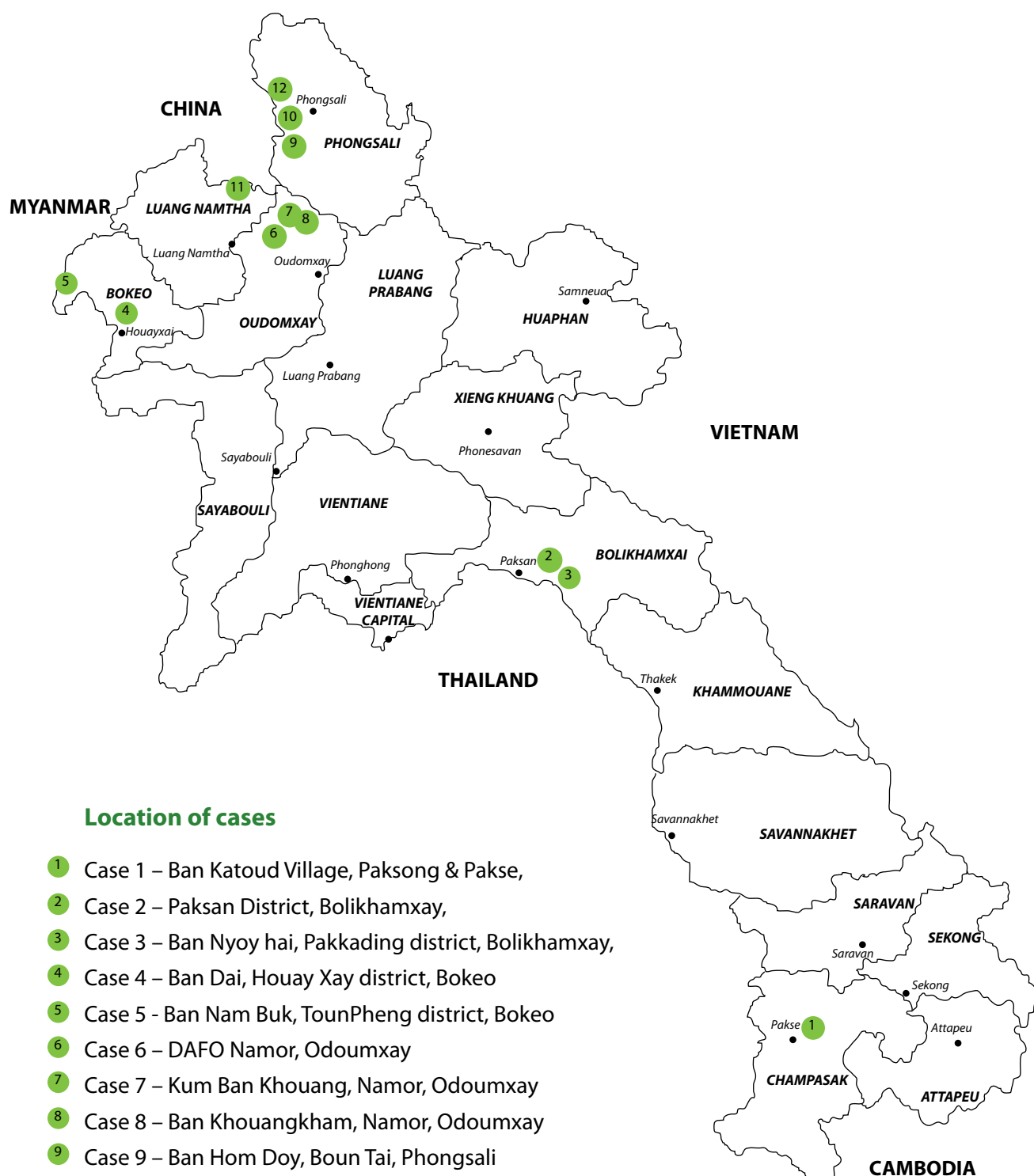
Uncovering and defining elements of success is necessary but in itself is not sufficient to bring in positive outputs and increased income of smallholder commercial producers. For agricultural households and communities across the country to benefit will require a sufficient response from the government and its development partners. The elements of success and the accompanying analysis, insights and conclusions must be interpreted and applied to shape principles, policies and practise for agriculture and sustainable livelihoods.

Evidently, turning the elements of success and the recommendations for DAFO into policy, practise and programmes will challenge budgets, legacy viewpoints, and above all imagination. Nevertheless, the inquiry has found that there are reasons to be quietly and cautiously optimistic about commercial smallholder agriculture in Laos. The inspiration to realize the sustainable potential of agriculture to reduce poverty, improve well-being, and strengthen the economy is out there in the fields among farmers and investors. It is important because after a century of decline the outlook for agriculture in a resource constrained world is bright (Grantham 2011) and in that is the promise of a profitable and prosperous future for smallholder farmers and sustainable agriculture in Laos. The promise will only be realized however if policies and programmes apply these elements of success.

2. Key findings

Cases	Findings	Section
1	Production-financed facilitators can connect farmers to distant niche markets for higher incomes	8.1
2	Screening farmers and offering land to land-limited farmers may lead to better farmer performance	8.2
3	A reliable investor providing close support can help farmers secure better incomes	8.3
4	Local investors may act as cartels but this may be the price of providing reliability and credit services to farmers	8.4
5	Commercial arrangements can increase smallholder production beyond the thresholds of ecological sustainability risking long-term decline in yields and incomes	8.5
6	Investment quality is improved when investors are required to assure performance by deposit of a bond with DAFO	8.6
7	Kin ties facilitate trans-national production for distant markets	8.7
8	Commercial arrangements avoid inefficient administrative controls, rules and regulations	8.8
9	Farmers can use agricultural markets information to negotiate better bargains with investors despite shortcomings of DAFO	8.9
10	Fraternal networks can facilitate trans-national production with foreign investors in ways which are more productive than investors promoted by DAFO	8.10
11	Farmers can improve livelihood security and reduce risks by splitting production between investors and traders	8.11
12	DAFO is powerless when an investor absconds leaving farmers without a market	8.12

Map of Lao PDR



3. Introduction

Smallholder farmers in Laos live and work in dynamic situation quite different to what they faced ten, and even five, years ago. New roads, more investment, near-ubiquitous telephones are opening up more farmers and their land to commercial opportunities. However, for farmers to share in the benefits of commercial opportunities and increase the returns to their land they have to overcome their limitations of financial capital, technology and access to markets. Among several options for commercial production contract farming presents a promising model because it provides a framework for farmers and investors to pool their assets and advantages for mutual benefit. Contract farming is an enforceable arrangement by which farmers agree to a price regime under which they will produce a crop for future delivery to a buyer who in addition to representing the market may also provide financing and technology¹.

Contract farming has been promoted by the government over the last decade as a mechanism for alleviating poverty among farmers and remains central to future plans (MAF 2010, 15, 16, 18, 20, 21). Contract farming is now well known. It is rare in discussions with farmers to find one who is unaware of the practice. If they have experience invariably they know someone who does or will point to the next village. The contention of contract farming in Laos is whether it is delivering positive outcomes for farmers and investors such that they may prosper over several seasons or more. The aim of this study is to identify factors which are conducive to success as well as consider opportunities for improvement.

An inquiry into success is necessary because discourse within Laos between government officers and agents of development partners frequently raises anecdotal reports of problems with contract farming which keep farmers in poverty. Reports in the newspapers have contributed to concerns that contract farming has been detrimental to the well-being of many farming households and communities. A nationwide field survey conducted in 2007 found some successful examples but also found several cases which had left farmers worse off because of investor manipulation, compromised local authorities, poor regulation, unsuitable crops

and information asymmetry (Fullbrook 2007). Fujita et al (2006 23-24) observed commercial pressures, including contract farming, combined with migration and denser population reduced or enclosed common lands with inequitable results for the poor or landless in Muang Sing, Luang Nam Tha. Diana (2008 91-94) noted contract farming in Luang Nam Tha, while having some positive benefits, was imposing unfair terms, with poor prices, in ways farmers often did not understand, and which were ignored by investors when convenient. Lin (2010 27) has highlighted farmers' vulnerability to sudden withdrawal by investors because they are poorly screened by regulators and face few consequences. Several studies, notably Shi (2008), have raised issues with the impacts and consequences, including loss of land or access to common resources, of use of contract farming to facilitate rubber in Luang Nam Tha.

In January 2011 the sub-working group agreed a study would help the government and its development partners to capitalize on the experience of contract farming and support efforts to improve performance in the years ahead. The primary aim was to identify factors conducive to a successful production relationship between farmers and investors by studying successful cases. The secondary aim was to identify opportunities for DAFO to foster equitable production arrangements between farmers and investors, and reduce instances of either side reneging on the bargain.

¹ Definition adapted from Eaton and Shephard (2001)

4. Research

4.1. Scope

The scope of this study encompasses agricultural production under arrangements between smallholder farmers and investors² and the parties to such arrangements including farmers, investors, investor representatives and government officers. The focus is on field crops for commercial sale. Field crops were chosen because production agreements are already common. Furthermore, the Ministry of Agriculture and Forestry is encouraging production agreements as a tool for farmers and investors to work together to increase production.

4.2. Questions

Two queries focus the data collection and analysis of the study:

1. Why are some contracts for production between farmers and investors successful?
2. What can DAFO do to foster equitable arrangements and develop the context to encourage good performance by all parties?

The first question is focused on outcomes which are successful. What however constitutes or defines success when standardized quantitative indicators are unavailable? Success was initially framed by two criteria.

First, time. Three seasons was set as a threshold to demonstrate each party saw sufficient value in the benefits to commit time, effort and resources. This attribute implies an assumption that if an arrangement continues then it does so because although it may not be optimal it is the best outcome possible given the alternatives allowed by the circumstances.

Second, qualities. Interlocutors were encouraged to judge whether they considered a production agreement a success and to suggest favourable qualities based on their experience. This approach created space for subaltern perspectives instead of imposing a set of external qualities and associated values. However, it was at times challenging for

interlocutors to express themselves without assistance. Comparison between cases was also harder. The criteria represented an ideal, a starting point. Inevitably not all the cases selected satisfied both criteria partly because the situation is dynamic. Nevertheless, attempting to frame success in this way focuses on proximate factors the parties experienced across a few seasons. Although such framing shaped the line of inquiry during research the matter of whether the cost of success today was undermining the prospects for success over longer horizons arose during discussions with informants.

Of several lenses which might be used to explore the costs of success and the impacts on sustainability or endurance it was the ecological which stood out. The concern is that successful arrangements may overtax ecosystem services, extracting resources in excess of the boundaries of natural regeneration. Thus success today maybe creating conditions for failure tomorrow in terms of insufficient production to maintain agreements between farmers and investors.

Having discussed efforts to frame success it is useful to consider the value, meaning and relationship of the questions. The first question can be considered effectively without recourse to the second question. The first question is essentially historical, asking why things have worked from the past until now. seeks factors associated with successful outcomes, although not all such factors will necessarily be facts.

The second question benefits from the first question because its findings provide information and insights about the context of opportunities for local authorities to facilitate and improve the process. This question attempts to engage the future, to explore what changes might be made to divert the current trajectory of the future to an alternative trajectory for a preferred future. In that sense it is reflexive.

The second question aims to find opportunities for policy, regulatory, and other interventions. Although the second question explicitly considers DAFO because of its role in smallholder agriculture and promotion of production agreements it is nevertheless analogous to several local government

² The term 'investor' generally connotes a person or company which has put up substantial time, human resources, capital (financial or physical), and/or otherwise contributed to enabling an agriculture production venture, and is expecting a return on the investment.

agencies involved in production agreements. DAFO receives focus for institutional and logistical reasons; however, most analysis and comment regarding DAFO applies equally to other local line-agencies involved in promoting production agreements. The second question explores to what degree DAFO, or any government agency for that matter, should be involved in commercial production agreements between farmers and investors: can they positively influence the outcome to improve the benefits for smallholder farmers or the process in general?

4.3. Approach

The approach included a limited review of literature and discussions with several government officers and staff of development partners in Vientiane. The main element was semi-structured field interviews with participants in the process of making and executing production agreements including smallholder farmers, investor representatives, investor compradors and officials. Interviews began with a common set of questions, some of which were omitted and others inserted based on the nature of the case and the limits of time. Observation and interpretation of physical circumstances was also used to inform and adjust structuring of interviews with participants.

Preliminary cases were arranged in advanced by the sub-sector working group on farmers and agri-business (SWGAB), in part based on information supplied by PAFES and DAFOs, several, particularly in the south, turned out to be problematic or no longer active. Of the cases included in the report five were the results of the researcher observing agricultural activity and requesting interviews and two were suggested by DAFO staff. Usually people were generous in making time for what were often long interviews to discuss and dissect experiences. In some interviews one or two officials from Vientiane were present. However this did not seem to prevent frank answers.

Preliminary findings were the basis for a workshop in Luang Prabang with selected PAFES and DAFO officers from across northern Laos and were also presented for discussion in a SWGAB meeting in Vientiane.

4.4. Cases

The cases are divided into several parts. Experience aims to relate as closely as possible how people perceive events and relates their thoughts and

perspectives, thus no claims are made as to the veracity views presented. The intention is to reflect and relate what is happening and how things are rather than what should be happening and how things should be. Observations consider the experience, analyzing the limited information available to develop a tentative understanding of the situation as a basis for assessing factors of success and drawing out preliminary insights. Conclusion summarizes the experience and observations. Success factors specify elements of success. Questions suggest lines of further inquiry and discussion.

Most cases relate the experience and perspective of one participant in production rather than the ideal of everybody, including farmers, investors, compradors, and so on. Cases therefore should not be interpreted as a final judgment but rather a starting point, a snapshot of experience rather than a comprehensive report of the facts. In general, the experience and perspectives of officials should not be interpreted as personal but rather as a reflection of the role, agency and capacity of local state agents.

4.5. Limitations

1. The budget inevitably constrained time, scope and the geography of research.
2. Time available for interviews was often less than an hour.
3. The effective absence of qualitative historical data recording and describing change in the distribution, scale and impact of production arrangements as a phenomenon in their own right as well as relative to overall agricultural production and general activity in the economy and among the populace and the relationship to the transition from poverty to prosperity.
4. Information given by informants in general could not be independently verified due to budget and practical limitations and is therefore taken at face value. Nevertheless, as many interlocutors chosen at random in the field, the possibility that interlocutors colluded, distorted information, or otherwise coordinated to protect their interests and so distort the findings is considered small.
5. The knowledge and capabilities of the study team.

5. A note on contracts, agreements and farming

Contract farming is an enforceable arrangement by which farmers agree to a price regime under which they will produce a crop for future delivery to a buyer who in addition to representing the market may also provide financing and technology. A contract is a binding agreement which can be enforced by recourse to means provided by law and mechanisms for hearing complaints and dispensing justice, such as courts.

In Laos the legal system is immature. Recourse to legal means is to all intents and purposes unavailable to parties engaged in an arrangement for agricultural production. Furthermore it will be some time before access to justice is affordable, convenient and timely for all, especially farmers who have little financial capital to spend on legal fees and attendance at court, if they could spare the time. Therefore to describe arrangements for production cooperation between farmers and investors in Laos as contract farming is misleading and raises unrealistic expectations for remedy should the arrangement turn sour.

An agreement is an arrangement in which two or more parties mutually recognize what tasks or actions each will perform. Farmers and investors frequently reach agreements for cooperation on agricultural production in Laos. They range from verbal to written, informal to formal, unregistered to registered. They are enforced by administrative, economic and social means. How enforcement works is an underlying issue the study considers in its analysis and recommendations.

This study, in general, eschews the term contract farming in preference for agreement farming or production agreement.

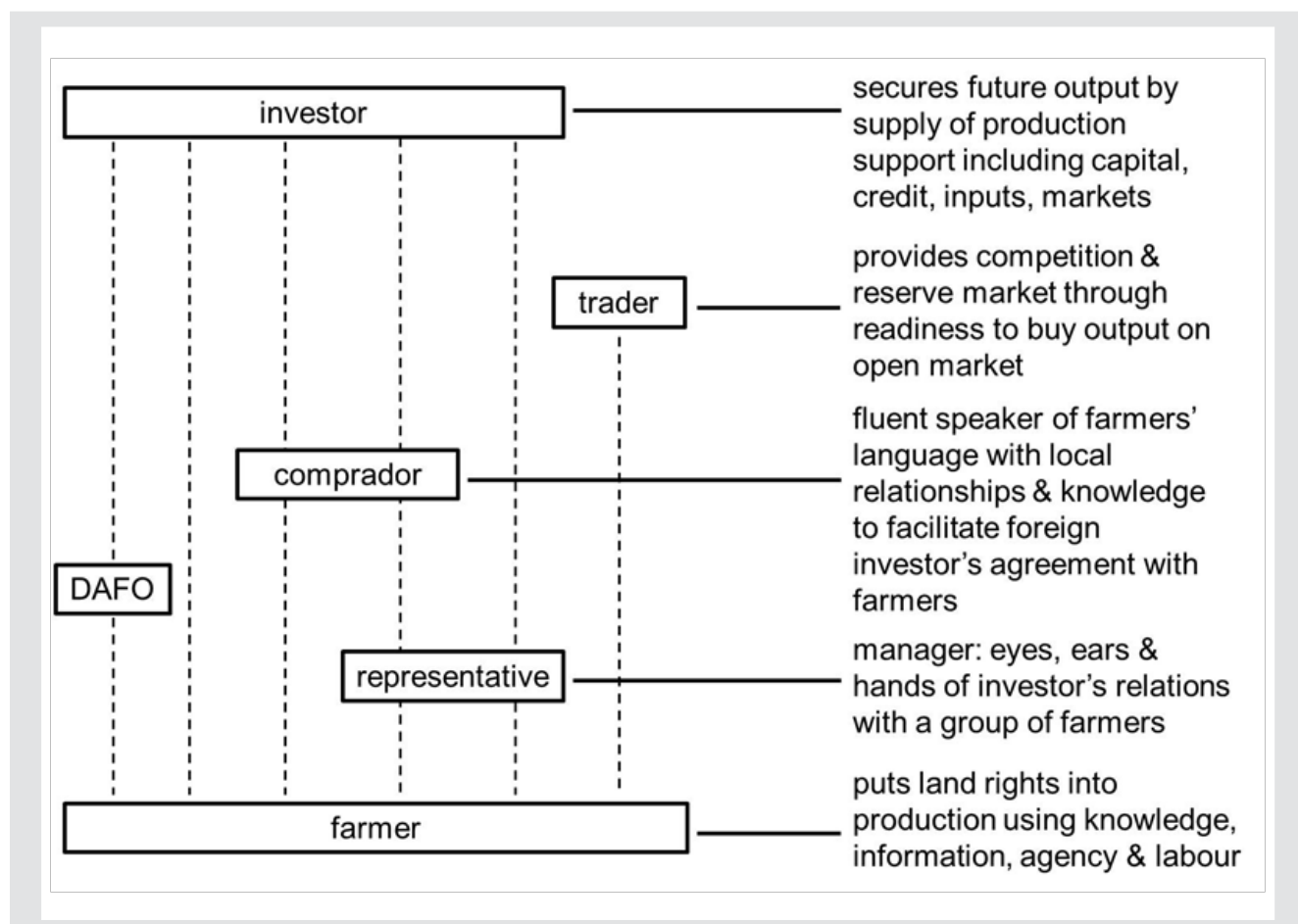
Language

Intentions and expectations are also at risk from misunderstanding from language and translation. In Lao the word commonly used for contract is *sanyaa*, which also means promise and agreement. Although the context often implies the specific meaning this is not always clear and the potential for confusion and mismatch of intentions and expectations, particularly between foreign investors and Laotian farmers is obvious.

However, when interlocutors are quoted *sanyaa* is translated as contract, though the sense in most cases is more that of agreement.

6. Agents and relationships

When smallholders enter into commercial production in Laos arrangements may involve several economic agents. Who participates may differ from place-to-place, season-to-season. Several possible relationships, roles and perhaps responsibilities are presented below in a production organogram. Relationships are presented vertically. However, horizontal relationships may also exist. For example, a group of farmers is a horizontal relationship. Conceivably, horizontal relationships, perhaps informal, may exist between the agents and between a farmer and an investor.



7. Context and trends

Farming agreements for commercial production between farmers and investors arise from a confluence of features of the socio-economic context and trends in environment, agriculture and demand. Although there are several factors which contribute to successful production arrangements between farmers and investors the context and trends establish a foundation and enabling an environment which supports prospects for success.

A brief review is useful for understanding why there are promising prospects for commercial agricultural production in Laos. The review considers elements of context and trends which may have impact upon the situation of farmers. It provides a sense of the changes in agriculture and demand which conspire to bring about a situation, for example, where an investor from Inner Mongolia travels 3,000 kilometres to fields in northern Laos to invest in production of watermelons for sale to people in the arid north of China. It does not imply any weight or hierarchy to elements or trends, a difficult exercise because their intensity and interaction is subject to constant change. An appreciation of the context and trends provides a basis for considering the situation of farmers several years hence and the implications for design of policy, programmes and institutions.

7.1. Context

The economy of Laos

The economy is growing rapidly because of heavy investment in production of raw materials and energy, with private investment now exceeding public investment and dominated by foreign sources (Lin 2010, 1). The former split between mining and agricultural commodities such as rubber, pulp and sugar. Agricultural commodities require extensive areas of land which has resulted in the replacement of forests and in some places food crops with rubber, acacia and eucalyptus. The speed and scale of change is well illustrated by the rapid transformation of Luang Nam Tha into a province of smallholder and plantation rubber production.

Increasing demand and expanded access through concessions and emerging land markets has facilitated the capitalization and transformation of land and its uses. As investment continues, there are for example around 200 mining exploration

licenses and dozens of hydropower plants under development, pressure may increase on land farmers use for crops and the water they need for those crops.

Existing rights and mechanisms for valuing land may be imperfect and insufficient to support farmers, provide transparency, and ensure equitable transactions enabling farmers to securely transition to new prosperous livelihoods. This may be because the value and prospects for farmers to use land to supply high-value products may be underappreciated. Several cases however illustrate that there is potential for farmers and investors to use production agreements to develop quality products for markets with high purchasing power, such as those in the northern cities of China.

Proximity to markets and comparative advantages

Laos shares long borders and improving transportation links with China, Thailand and Vietnam. As the cases illustrate activity, opportunities and competition for the products of Laotian farmers appears to be greatest along the frontier with China.

Inquiries into cases which were not successful and are not described in this study suggest that where farmers' primary export market is Thailand they are at considerable risk of price dictation, oligopsony and unscrupulous practises by cartels of Thai buyers, possibly allied with officials. This may be because Thailand is a major exporter of agricultural products with broadly similar production conditions to Laos. The major advantage of Laos is lower prices for some he incentives are not strong enough to encourage Thai buyers to take a longer view of their investment or trading relations with farmers in Laos. Farmers in Thailand also face considerable difficulties. Thus the Thai market does not present many comparative advantages for Lao farmers.

China is by a small margin a net agricultural importer. Less than half the population lives in the tropical or sub-tropical south. The north is cold and dry. Drought is a perennial challenge for agriculture in the north with production dependent upon unsustainable use of finite aquifers. Drought is also a problem elsewhere, having hit Yunnan hard in recent years and this year part of the lower Yangtze River basin. Tropical, water-rich Laos is complementary to many markets in China, especially major cities

inland or in the north. Buyers are coming from markets across China (cases 7, 9, 10, 11 and 12) to secure production from Laos through investment via production agreements with farmers. Some are looking for commodities like maize or sugar cane (Lin 2010, 10, 12, 18) of which Laos might not be the lowest cost producer due to scale and other factors. Others however are looking for pumpkins, watermelons and bananas, for example, in which Laos may have several advantages. Field-crop investors and traders from China are already active as far south as Bokeo and Oudomxay. As roads improve and conditions in China evolve their interest and competition may increase and expand.

This study has not researched cases of investment from Vietnam in agricultural production with farmers through production agreements. Vietnam is now a major agricultural exporter, second only to Thailand in rice, for example. On the other hand, Vietnam has a population density comparable to some places in China and is, like Laos, mostly mountains. Therefore, depending on the crop and local conditions on either side of the border between Laos and Vietnam farmers may either find themselves in a disadvantageous situation similar to that along the Thai border or an advantageous complementary situation not unlike that with the markets of China. Proximity to large prosperous neighbouring markets is then a bane in the case of Thailand, probably a blessing in the case of China if farmers can meet the needs of niches and avoid being overwhelmed by powerful capital forces, and perhaps a bane and a blessing in the case of Vietnam. Increasing the benefits of the opportunities of neighbouring markets will *inter alia* require improvements in networks, capabilities, information and transportation. Such improvements are arguably already taking place.

Agribusiness competition

Several countries share broadly similar climatic and agricultural conditions to Laos and are established or emerging agricultural exporters to China. Thailand is a significant exporter of food and materials to China. Vietnam is a rapidly developing agricultural exporter, although trade with China in some products may be limited because of the agricultural challenges facing Vietnam. Cambodia is also developing agricultural exports, particularly rice. The most significant emerging agricultural exporter is Myanmar. Development of power plants, plus road and rail links with China over the next several years and substantial investor interest from China favour

better prospects for agricultural exports. Fish, for example, has been exported by truck to China. The potential is evident from the country's position prior to independence as the world's leading rice exporter (Turnell 2007, 4).

Competition for smallholder farmers in Laos from agricultural exports from Vietnam or Myanmar is a risk in terms of price, quality or quantity. On the other hand, demand in China is increasing and greater availability of agricultural supplies from neighbouring producers may displace supplies from more distant producers. Competitive risks may be countered by developing relationships with investors, focusing on high-value niches, and improving productivity.

Strategic interests of China

China's strategic interests in Laos suggest Laotian farmers will be favoured by trade regimes and investment promotion. China has encouraged investors, especially large companies, to look abroad for opportunities with the Go Out policy. China's interests in Laos are security and resource supply. China's Periphery Policy³ seeks to develop cordial relations with border states and support their economic development and stability (Zhao 2004). China gives considerable bilateral development aid to Laos and state firms are active investors. China strategic commodities policy strives to secure supplies of commodities, including rubber, critical to the stability of the economy and national security. Companies from China have invested in smallholder and plantation rubber in Laos at an unprecedented scale and speed over the last five or six years. Rubber and other agricultural investment has been supported by China's Poppy Alternative Development Programme in Laos, aspects of which have been elaborated by Shi (2008) and Lin (2010, 14). The programme also provides a preferential channel, including quotas for some products for agricultural exports from Laos that might otherwise draw tariffs and face phytosanitary controls (Lin 2010, 15-16). Agricultural tariff regimes are governed by the China-ASEAN Free Trade Agreement since 2010. There also appear to be various trade-promotion agreements and initiatives between local administrations in Laos and neighbouring administrations in Xishuangbanna⁴.

³ Or Good Neighbour Policy

7.2. Trends

Information and communication

Mobile telephones are becoming a common tool among farmers. Several mobile telephone networks are aggressively marketing services, including third-generation data modems, in rural areas. Telephones are a tool for accessing, distributing and discussing market information, including prices, investor quality, production issues, and crop varieties. As several cases illustrate Laotian farmers call to China and Thailand to check prices, liaise with compradors or obtain technical information.

Mobile telephone use will increase because of its value as a market and social tool and also because mobile telephone companies will continue their marketing to expand use to generate revenue to recover their investment. Access to electricity also supports expansion of mobile-telephone networks. Continued development along this trend will see farmers learning accessing even more information networks, including the internet. Farmers' demand for market information and knowledge is an opportunity for a service provider or the mobile networks, which are promoting data services to increase revenue.

Resulting from these various developments in the private sector, in three-to-five years farmers in Laos may be significantly better informed about market prices and opportunities and have contact with a large pool of investors. Their ability to interpret, analyze and understand prices may not develop as quickly, however. While various conditions may continue to constrain farmer choices, information will invariably increase options and lead to greater farmer choice.

Shifts in food and material production and security

Globally demand for products from the land is increasing because of population growth, greater prosperity, urbanization, oil risks and climate change. Food consumption is rising and food production is becoming more extensive because of relative increases in the consumption of feed-intensive

porcine and bovine meats. Rising oil prices and concerns over supplies, supply security and environmental impacts are favourable for increasing demand for substitute materials produced by agriculture, such as natural fibres or plastics produced from starch. Urbanization increases the proportion of the population dependent upon farmers and markets for their supply of food and materials. Expansion of urban areas can result in a loss of land or water for agriculture. Land for agriculture is also under threat from pollution, water competition, drought and desertification.

These trends are contributing to the increases in the production costs of agricultural products, as projected by the OECD and FAO in recent Agricultural Outlook reports⁵. These factors and their transmission through global and regional prices for cash crops imply stronger demand, better incomes and higher land values for farmers in Laos in the years ahead. Conversely, demand for products amenable to production through corporate plantations, such as rubber, pulp and sugar, may intensify efforts by investors to gain control of land through concessions which may displace farmers or affect their access to common resources such as water. One factor which may influence access to land is whether the state can derive sufficient revenue from taxation on farmer incomes to be a viable alternative to revenues from concession agreements and taxation on corporate plantation income.

Agricultural challenges for China

Agriculture in China is under pressure from urban and industrial expansion across the country. Desertification is affecting agricultural lands in the northwest. Declining aquifers pose a major risk to production in the north, especially of wheat. In recent years drought has reduced agricultural production in Yunnan. Pollution of soil and water is a major problem for agriculture. A reversal of these trends is not foreseen. Production in neighbouring countries can compensate for domestic losses and to minimize dependence on distant agricultural production and the risks of world markets. This may favour investment in land and production agreements with farmers in Laos, as well as Cambodia and Myanmar.

⁴ Such an agreement may have had some bearing on trade and investment in Muang Sing in Luang Nam Tha (Fullbrook, Contract farming in the Lao PDR: cases and questions 2007) while investment in Oudomxay by Chinese investors is supported and supervised from Bohan, China, explained Houndaeng Paengpajang, DAFO Namor, Oudomxay

⁵ OECD-FAO Agricultural Outlook, <http://www.agri-outlook.org>

Qualitative change in demand in China

China's population is growing and is becoming increasingly prosperous. A majority of people in China are now urban. Increasing wealth generally translates into higher demand for meat, especially porcine and bovine, which requires extensive grain production to produce feed. Food demand in China is therefore increasing not only in terms of quantity but is also changing qualitatively in terms which require greater areas of production. The changes in demand and the limitations on agricultural land in China may be contributing to higher prices which displace production of lower-value products, like pumpkins and watermelons, to Laos. Research for this study indicates banana investors have been exploring opportunities in Bokeo and are already active in Oudomxay and Phongsaly. It may also be noted that land available for tropical crops in Yunnan and Hainan is limited because substantial areas have been used for rubber. Rising wealth and increasing purchasing power for discretionary foods, such as watermelons and pumpkins⁶, is favourable for farmers in Laos if they can connect with quality investors. The challenge is preserving for smallholders in the face of demand from corporations for plantations for rubber.

have interests, capabilities and capital which favour developing long-term investment relationships with smallholder farmers.

7.3. Implications

Smallholder farmers in Laos live and work in dynamic situation quite different to what they faced ten, and even five, years ago. The changing context and powerful trends are reshaping demand in ways which are favourable. However, they are also supporting forces which require land for industrial purposes. For smallholder farmers to prosper they will need to generate sufficient income from the dynamic situation by exploiting opportunities created by changes in the economy and environment. To do so, they will need to produce higher-value crops for wealthier markets. Forming robust links with those markets faces challenges of distance, language, knowledge, technology and trade regimes. For farmers to develop those links will be a challenge. Even selling directly into markets in neighbouring parts of China and Thailand may not necessarily offer the greatest returns if they face an oligopsony. An alternative is to use production agreements as a basis for developing relationships with investors from wealthy markets. They may

⁶See appendix for examples of differentials between prices at the farm gate in Laos and retail in Beijing

8. Cases

Research to identify and document cases was conducted in southern and north-western Laos. The majority of cases are from the north. This bias is a consequence of two visits to the north because cases found during the first visit provided richer findings than those in the south. The research revealed a more vibrant business environment with greater opportunities for farmers and investors in areas within a day's journey from China, where investors from across China were found to be active through their compradors, compared with areas close to Thailand, where investment and trade appeared to be more tightly controlled by well-connected oligopolies or monopolies. No research was conducted along the frontier with Vietnam.

8.1. Case 1. Closing the gap: facilitators, investors and farmers

Ban Katuad, Paksong & Pakse, Champasack



Mr. Souriyet, deputy head of coffee production group

*Production-financed facilitators
can connect farmers to distant
niche markets for higher incomes*

Experience

Coffee is flourishing on the rich volcanic soils of the verdant Bolaven plateau in southern Laos. Smallholder farmers have seen their fortunes pick up in recent years as more and more people around the world enjoy coffee but also demand better quality, like the Arabica grown on the Bolaven. Many farmers have not benefitted as much as they might have from rising world coffee prices, however. Farmers commonly borrow money from traders who accept pledges of coffee beans as collateral. Traders may to varying degrees be able to dictate prices because of advantageous information, capital position or handling capabilities. Credit provided by traders however may be seen as a social service, a facility farmers wish to maintain in the absence of better alternatives. Some of the asymmetries between farmers and the market are due to a lack of capital

and organization into effective production cooperatives. There are, however, two examples of intermediary organizations which have helped farmers organize, provided technical support and most importantly links to markets which pay higher prices contingent on quality. Although both l'Association des groupements de producteurs de café, or AGPC, and The veda coffee cooperative are intermediaries, not investors, fulfilling similar roles they do so in slightly different ways. Unlike commercial middlemen, who aim to maximize value they extract from the production chain through fees and prices offered to buyers and sellers, AGPC and coffee cooperative minimize the cost of their services to farmers.

AGPC is a local organization which was launched in 2005 as part of a project supported by Agence Française de Développement (AFD). In an upstairs meeting room of a charming old house doing service as offices in Pakse, capital of Champasack province, Chansamone Lomany, general manager, explained how AGPC worked with farmers and buyers.

On the supply side AGPC has helped farmers to establish 53 production groups, cultivate better varieties, improve processing and achieve Fair Trade and organic certifications. Farmers pay a membership fee to their group. AGPC deducts administration costs, plus tax and shipping charges from the price it pays to farmers for the coffee. On the demand side AGPC uses its marketing capabilities to develop relationships with foreign buyers, especially

European, who pay higher prices for Fair Trade and organic coffee.

Each year AGPC makes an agreement with each group for quantity, quality, price and delivery time. Groups in turn reach individual agreements with farmers. Farmers split their coffee harvest between traders and AGPC. They typically still sell a majority of their crop to traders because although AGPC pays better prices the payment is split into two tranches because this is how buyers pay AGPC. The split payment presents an opportunity cost many farmers cannot afford so they also sell coffee beans to traders who settle immediately in cash, albeit at lower prices. The agreements between AGPC, groups and farmers are enforced by economic means. If a farmer or a group fails to deliver according to the terms of the agreement then they are banned for one season from dealing with the group or with AGPC.

Less than an hour's drive from Pakse up on the Bolaven beneath leaden skies, occasionally sprinkling rain, stands Katoud, a village strung along the blacktop highway, where behind the houses coffee bushes grow thick beneath taller trees providing shade. Souriyet Wongwianit is the accountant and deputy head of a group of 87 households growing mostly Arabica catimor and some typica.

In 2003 Oxfam Australia introduced ATG, a company in Japan, to the farmers. ATG built warehouses and supplied a processing machine while Oxfam Australia helped farmers improve their skills and organise producers as Theveda coffee cooperative. In that year the group sold 13 tonnes to ATG. Now they sell about 3 tonnes, or five percent, of their output to ATG. The rest is sold to local traders. Souriyet expects Oxfam and DAFO will promote Arabica sava, a more resilient variety with better taste and higher yield developed by the government's Coffee Research Station.

The cooperative signs agreement for quantity, price and delivery time with the company. If they fail to supply the agreed quantity they have to provide an explanation. The experience so far has been positive, farmers have always paid on time. "Having the contract is good because it gives a fixed market and the company will pay more if the market price rises, but sticks to the contract price if the market price falls," said Souriyet. He thinks the relationship has developed because ATG has invested the time to meet, discuss and eat with the farmers and also pays good prices.



A member of coffee cooperative drying coffee beans

Observations

Initially farmers and foreign buyers were unaware of each other and the potential opportunity. Buyers were looking for a product which met certain conditions and were willing to pay a premium. Farmers were willing and able, with assistance, to produce to those conditions at a globally competitive price. The potential opportunity was realized by the actions of AGPC and Oxfam Australia, which have provided intermediary services at low cost to facilitate the opportunity.

Services provided by AGPC and coffee cooperative are financed by users who pay fees to cover costs. AGPC recovers its costs through an administration charge paid by the farmers. Coffee cooperative's intermediation services and assistance is paid for by ATG, the Japanese coffee buyer.

Although AGPC and coffee cooperative do not seek profit in financial terms, which would discipline and measure a commercial organization, their profit can be measured in social terms by reduction in poverty and improvements in livelihoods. If there was no perception of benefit then farmers may not spend their time cooperating with the facilitators. While users perceive a cost-effective benefit they are likely to continue paying for the services of AGPC and cooperative which suggests that although they do not make a financial profit the social return they provide to the community will ensure their sustainability. Therefore, intermediary services may be a role amenable to social enterprises if farmer organizations are unable to undertake such duties.

AGPC and the cooperative support the fulfilment of agreements in two ways. One, they overcome obstacles, such as insufficient information, distance and language, to bring farmers and buyers together and support their relationship with technical services. Two, unlike middlemen they do not obtain a profit from handling the exchange between buyers and sellers, which enables buyers and sellers to capture more value because they are not accepting prices dictated by a middleman. The services provided by AGPC and cooperative support successful agreements by connecting producers and buyers with a strong interest in the value each provides to the other which is expressed in competitive prices.

The impact of the services provided by the facilitators is clear. What is unclear is the impact of farmers splitting their beans between investors

bound by agreements and open-market traders. Quality is one factor which can affect how much of a crop farmers can produce for buyers under an agreement. Farmers also have to be careful about promising more than they can deliver because of the risk of penalties, such as being blacklisted for a season.

Farmers may also be bound into dependency relations with traders who supply them with credit. Farmers need to maintain their relationships with traders who may limit credit partly on the basis of how well they know and trust the farmer. Moreover the pool of capital for traders to lend is limited. Circumstances conceivably may arise in which demand for credit exceeds supply. Traders can manage that by raising rates. However, relationships provide a competitive advantage in some circumstances. Were farmers able to access affordable and reliable credit from sources other than traders they may be able to adjust the supply of beans to traders and investors in the favour of investors. One way to reduce the credit dependency farmers find themselves in with traders would be for investors to advance partial payment early in the season. On one hand that would leave investors with greater risks in terms of default by farmers, on the other farmers might be able to supply a greater quantity, assuming beans satisfy quality criteria.

It may also be the case that farmers benefit from a degree of competition between traders and investors entering production agreements. Whether farmers tacitly consider this in their decisions about production and with whom to deal is a matter for further study. Nevertheless, the prospect of returning to a situation where the only buyers are traders may function as an economic incentive for farmers to try to fulfil agreements with investors.

Conclusions

- There are opportunities for equitable production which pay a premium and can support smaller quantities
- A buyer which prizes secure supply of quality product as much as price, if not more so, is a favourable condition for production relationships
- A third-party can facilitate bargains between parties which might not otherwise have met because of insufficient information Realizing opportunities may require technical assistance to implement certifiable production and trade systems

- Fulfilment of agreements may be due to direct economic incentives as well as indirect incentives to maintain competition between traders and investors
- Realizing economic opportunities may require active intervention – well placed visible hands can improve the quality of the market and opportunities
- The scope, scale and impact of agreements may be partly due to the availability of credit

Success factors

1. Facilitators fill the gaps in a fragmented market to match farmers and buyers in a high-value opportunity giving each a strong incentive to fulfil production agreements
2. Parties make time to develop the relationship and foster understanding
3. Buyers who value quality and are willing to invest in developing quality
4. Certifiable production systems which communicate value and draw higher prices

Questions

- a. If facilitators were to withdraw could their capabilities and services be transferred through training to producers and buyers?
- b. How can facilitators be established to efficiently realize potential opportunities in other districts and products?
- c. What role is there for facilitators driven by financial profit?
- d. What could DAFO or other state agencies do for international facilitation given their respective capabilities?



Thevada coffee cooperative sign board

8.2. Case 2. Prizing land: mixed motives, reputations and incentives

Paksan district, Bolikhamxay



Maize field under long term production agreement

Screening farmers and offering land to land-limited farmers may lead to better farmer performance

Experience

In Bolikhamxay province, stretching from the banks of the Mekong up into the highlands, the State Commerce Food-Stuff Enterprise, or SCFSE, has production agreements with farmers for cassava and maize. Sitting in a spartan government office beside Route 13 South Vieng Simkhampha, SCFSE's vice-director for Bolikhamxay, and Kaewvisaed Sulimasing, head of SCFSE's Bolikhamxay extension unit, explained how the state enterprise has been making agreements with farmers since 2008.

"Before 2008 the company bought from the farmers but the quantities were not enough for export. The company wanted to increase the quantity so to promote production the company has been using contracts to supply inputs and support," said Vieng. Government policy to support commercial production by farmers to reduce poverty was another factor. "One of the reasons for making the contract

was to tackle three problems identified by the government of access to finance, inputs and marketing," adds Kaewvisaed.

Cassava and maize is sold to Lao Indochina, CP Lao and Hang Nga for export to Thailand, Vietnam and possibly China. Agreements are for the farmer's labour and land for five years because this is the duration of the company's contracts with its buyers. If a farmer withdraws early the production agreement gives the company the right to employ its own labour to use the farmer's land until the agreement expires. In addition to inputs, the company will request more land for farmers who have insufficient land to produce reasonable volume of output. The company borrows money from the bank to finance its support for production agreements with farmers.

Vieng and Kaewvisaed think production agreements used by SCFSE have been successful for several reasons. Time is invested in developing relationships and understanding with farmers. At least three meetings are held with farmers before agreements are signed between farmers and groups, groups and SCFSE. Not every farmer interested in a production agreement is accepted. "We will take account of the comments of the village authorities in choosing who to work with," said Vieng. "We also consider the members of the household, if they have enough labour, whether they are drinking or using drugs a lot, then we will not work with them," adds Kaewvisaed. Nevertheless there have been some difficulties. "The issue of the benefits for both parties has to be made clearer, it is difficult and improves only slowly step-by-step," said Vieng.

Observations

Several factors for success, in terms of duration of participation by farmers, have been identified by SCFSE. One, farmers who express interest in making production agreements are selected based on their reputation, judged by village officials and perhaps peers, for work, competence and sobriety. Two, SCFSE tries to find more land for farmers with insufficient land creating an incentive for poorer farmers to participate as well as a mechanism to discipline their participation. Three, SCFSE holds at least three meetings with farmers to explain and discuss the conditions of the agreement. Even so, as Vieng points out there still appear to be problems. Misunderstandings between SCFSE and farmers may be one cause. Administrative or economic penalties designed to enforce the

agreement may be ineffective because farmers retain agency to challenge the agreement if they feel the terms are no longer in favour as conditions change across time.

SCFSE has made agreements with farmers for two reasons. One, to produce and increase supply for clients. Two, support and implement government policy. SCFSE is using agreements to extend control over the cultivation practises and technologies used by farmers to increase supply of commodities, which are subject to strong regional and global demand trends. If farmers withdraw, SCFSE retains access to their land, suggesting that land is coveted more than the labour and expertise of the farmers because land is the medium of production. Whether this is indicative of an underlying preference for a plantation concession rather than production agreements with landholding farmers is an open question. It is worth noting that their arguments for and against each mode of production and both have found expression in Laos. In 2007 Mitr Lao, the subsidiary of Thai sugar combine MitrPhol, entered Laos expecting to develop a plantation, whereas Chaiyo AA, a subsidiary of Thai paper miller Advance Agro, preferred to work with people rather than the land directly (Fullbrook 2007, 33, 38).

Why then has SCFSE made agreements with farmers? Securing direct control of land may not have been possible, although the rapid expansion of concessions over the last decade casts doubt upon this explanation. Alternatively the strongest factor may have been an instruction to engage in production agreements to support government policy. There is then reason to doubt SCFSE has primarily engaged in production agreements with farmers because it is the commercially-optimal choice.

It is unclear whether SCFSE is subsidized or receives other preferential treatment such as advantageous credit arrangements from state banks. It is not known whether this state enterprise has to make a profit and is responsible for its own losses. If SCFSE does not operate on a fully commercial basis, which is not unusual for state enterprises especially in transitional economies, then decisions to enter production agreements with farmers may not necessarily reflect commercial realities and in that sense may either be unsustainable or be a form of partial-subsidy delivered through a semi-commercial mechanism of a state enterprise. Success in this case may not be sustainable or replicable if the interpretations and explanations are correct.

That said, elements of success cannot entirely be dismissed either.

The role and interests of a state enterprise are not all that makes this case unusual. In general, farmers and investors agree new agreements each season, even if they have been cooperating for several years. SCFSE's preference for an extended arrangement for five years may reflect its realities as a relatively large company, and also perhaps its power. Whether farmers prefer a seasonal or extended arrangement requires further inquiry. However, given the risks, experiences and perceptions of production agreements farmers in general may be wary of extended agreements, depending upon the terms, but might feel more comfortable when the investor is a state enterprise which cannot withdraw across the border. That farmers and investors who have built a relationship frequently continue to use seasonal arrangements may indicate that the flexibility that this implies avoids complications which could damage the relationship. Further, flexibility could be a response to the relative immaturity and flux in commercialization of smallholder agriculture. When a relatively stable equilibrium is reached in the practises and structure of commercial smallholder agriculture confidence on each side could reach a level whereby extended arrangements are attractive.

Conclusions

- A considerable amount of time is required for investors to build relationships and understanding with farmers
- Expected production volumes may be supported by selecting farmers with good reputations
- Providing land may provide an incentive for farmers to participate and fulfil agreements
- State enterprises may use production agreements for commercial and policy reasons
- Access to and control of land may be more important to investors than the labour and know-how of farmers

Success factors

1. Investing time to develop relationships and understanding with farmers
2. Making agreements with farmers after checking their reputation for production
3. Providing incentives such as access to land which offer to increase income potential

Questions

- a. What are the social, economic and political implications of screening farmers?
- b. What practises can ensure screening is fair, transparent and insulated from abuse?
- c. Why should local authorities require a request from an investor to consider leasing or transferring land to farmers with insufficient land?
- d. What safeguards are in place to ensure farmers do not lose access to their land during the contract should their output fail due to circumstances beyond their control?
- e. Why are extended production agreements uncommon?
- f. What strengths and weaknesses do farmers and investors see when they compare seasonal and extended production agreements?

8.3. Case 3. Imposing terms: fixed prices, dependable buyer

Ban Nyoyhai, Pakkading district, Bolikhamxay

Experience

Along either side of Route 13 South in Bolikhamxay lie fields of plants with large pale green leaves and occasionally small white flowers. This is tobacco and it is often grown under investment by the Lao Tobacco company, a subsidiary of Imperial Tobacco, in production agreements with farmers. Beneath the shade of a few trees beside a tobacco barn Khampa Lovanxay, head of the tobacco-growers group in Nyoy Hai discussed the experience of production agreements with Lao Tobacco since 2003.

Written agreements are made between Lao Tobacco and the production groups. Farmers individually sign for their agreed production quota with the group. Prices are fixed according to the grade of leaf. If their output fails to meet the quota they are fined 3,000 kip for each kilo they are short. Lao Tobacco has committed to buying all the tobacco produced by the farmers. Khampa described how the agreements have delivered benefits. "We need a guaranteed market. It's convenient to have the contract, we get inputs under the contract, I don't have to put all my money in tobacco, I can get the inputs in advance and pay back after the harvest. We also get access to technical staff who come to monitor the tobacco. That's why we will stick with the contract in the future."

Since the introduction of production agreements Khampa points out farmers have seen their incomes improve. They have been building better houses, buying vehicles and repaying loans for school fees.

Company representatives often meet with the farmers to discuss the crop and hear their views. Nevertheless farmers feel the company is not listening. "They are very friendly when discussing the work, it's easy to meet with them and they ask for recommendations for solving problems. The company considers our suggestions to adjust the contract but doesn't do anything. I need the farmers to be more involved in drafting the contract," said Khampa.



Mr. Khampha with his tobacco barn

A reliable investor providing close support can help farmers secure better incomes

The farmers are unhappy about two issues. First, grading of the quality of leaves after harvest and drying. Disputes are common. The company decides the quality, with a lower quality earning farmers a lower price. Second, farmers feel they would be better off with an agreement pegged to market prices instead of the fixed prices the company insists on. Khampa thinks farmers negotiating position would be stronger if they had information about laws and regulations.

Observations

The farmers value the guaranteed market for whatever they produce and the supply of inputs. The farmers associate improvements in their prosperity with the agreement. An alternative explanation is that the agreement coincided with a period of rising market prices which have been reflected in the price fixed in the agreements. The farmers view could also be a reflection of facing a monopoly or oligopsony or significant obstacles to selling at tobacco markets across the Mekong in Thailand.

Lao Tobacco closely attends to the crop, which is regularly monitored by its extension staff. The company also meets regularly with the farmers, even if it seems it does not give much weight to their recommendations or complaints. Nevertheless frequent appearances by amiable company staff help build relationships, develop understanding of the farmers' concerns, as well as the state of the crop. The agreement appears secure having endured for nearly a decade. It may have become ingrained practise, the received way for the farmers to produce. If so the farmers' relationship with the company exhibits characteristics of dependency. Yet, the relationship is not so comfortable. Farmers think they would be better off with market prices.



A farmer attending her tobacco field

Given their relative prosperity the assets of the farmers, including production knowledge, could be sufficient for developing their own production if the returns were clear and they were confident of overcoming obstacles to a reliable market.

Conclusions

- A company can use amiable respectful staff to build relationships with farmers through frequent meetings
- Farmers' interest in maintaining an agreement strengthens with clear evidence tangible benefits will continue to accrue securely Farmers appetite for the risks of the open market, despite expectations of higher returns, is to some degree inversely correlated to the investor's dependability in supply of inputs and purchase of output

Success factors

1. Investor's staff are regularly in touch with farmers in a friendly and respectful way
2. Investor commits to be a reliable partner in supply of inputs and purchasing all output

Questions

- a. If farmers' relationship with Lao Tobacco is one of dependency how might it end?
- b. Why can the company continue to insist on fixed prices and retain the right to be the sole arbiter of the quality of leaves?
- c. What obstacles do farmers face in finding more buyers and better prices and terms?

8.4. Case 4. Cartels and the bargain of social benefits

Ban Dai, Houay Xay district, Bokeo



Mr. Lan, a maize producer in Bokeo. Many producers like him prefer to invest on their own and sell in open market

Experience

Ban Dai is a bustling village beside the Mekong in Bokeo province, about half an hour's winding drive south of Houay Xai between the river, low hills and fields. Somdee Somwongdet, Oonhern Pornprasert and Boonlern Saiwong are three local investors who gathered to discuss their experiences and perspectives on production agreements with farmers. They appeared to be comfortable with each other and on good terms.

The investors have been engaged in production agreements since 1994, when they were selected or instructed to take up their role in production by the state. The investors have written agreements for maize, rice, peanut and since this year cassava with representatives who make their own agreements, verbal or written, with farmers. Through the representatives each investor is working with

Local investors may act as cartels but this may be the price of providing reliability and credit services to farmers

between 200-500 households. The agreements cover supply of inputs and delivery of crops at market prices⁷.

The investors believe the arrangements have endured because they act transparently and are in regular contact with the farmers. The traders also selectively lend money interest-free to farmer who face unexpected expenditures, such as medical bills or a wedding. In the early years there were some instances of farmers selling off-contract to traders. Investors say they dealt with infringements in discussions with accused farmers rather than legal or other formal methods of enforcement. Their confidence is such that they hope to expand. However, their plans for expansion may require technical and possibly financial assistance from district or provincial authorities. To the west and south of Ban Dai the hills open up into a wide flat valley cut and diced into hundreds of fields studded with trees. Much of this land is held by farmers who have production agreements with one of the Ban Dai investors. Among them is LanSaiwong, 21, whose family has had production agreements for ten years with a representative for Somdee. The agreement is attractive because they lack capital and a large tractor for field preparation, he explained. He also sometimes sells maize across the border to Thai traders. His family appear to be prosperous. In 2006 the family bought a motorbike, a truck in 2008 and a hand tractor in 2010 apparently with money earned from agriculture production.

Nevertheless, Lan and other farmers would prefer to invest by themselves as they dislike being in debt for inputs, the price of which is marked up 20 percent by the investors. "If we don't have money of course we will get the seedling from them. If we have money we can invest by ourselves and sell to Mr Champa [a trader] for a higher price. In the next few years I prefer to invest by myself for two reasons. Firstly, I don't like being in debt. Secondly, inputs cost less if I buy by myself with cash. Most people want to invest by themselves. Maybe half the farmers in this area will be able to invest by themselves in two to three years."

Commercial factors are having a greater effect on the context of production, expanding as the state's presence in terms of support for farmers appears

to contract. Lan said the farmers rarely see DAFO, although the organization did a new variety of maize seed last year. Champa, a trader, appeared a several years ago offering prices Lan and his colleagues find attractive. Lan believes the price of maize is rising because the price of inputs is rising⁸.

Observations

Production agreements have been used in Ban Dan for 17 years. The arrangements appear attractive. Farmers receive a market price, access to interest-free credit when unexpected costs arise, and inputs at prices only 20 percent higher than the market price, which they can only access if they are willing to invest time and pay transport costs. Investors can obtain products at competitive prices in sufficient quantities generate an income which justifies the risks they take in advancing inputs to farmers on credit.

The agreements are enforced in two ways:

1. Social mechanisms – the sense of family implied by the investors in their commercial relationships with farmers and kin relationships plus reputations
2. Economic interests–market prices and availability of interest-free credit, which also has a sense of social obligation and reputational impacts



Mr. Boonlern, a local trader investing on maize contract

⁷ As noted the investor often determines the market price from several benchmarks, although in Bokeo farmers can call on their mobile phones to friends and relatives across the Mekong in Chiang Rai, Thailand, to check prices, which may not be the result of competition but collusion among Thai traders

⁸ Although he cites a push factor the greater impact on maize appears to be the pull factor of rising world demand and increasing competition for agricultural land from various crops

The incumbent investors may function as a cartel, establishing exclusive areas for production and set prices, according to market yardsticks, and obstructing the entry of more investors. Although the investors may cooperate and exercise oligopsonic power it does not necessarily follow that more investors competing openly with production agreements for farmers across the same area would deliver better overall terms and benefits for farmers.

Reliable performance by the investors in providing inputs, buying output according to the terms of the agreement, and providing interest-free credit are valuable in their own right and impose costs and risks investors can only bear because of the scale of their operation and the ability to control and forecast output through production agreements. Interest-free credit is an important social benefit for the community. While more investors might result in cheaper inputs and higher prices, they might have a lower capacity for providing interest-free credit and may lack the resources and resilience to always deliver inputs in time and follow prices and quantities in an agreement.

Lan did not suggest the terms offered by the investors were poor or unfair. Nevertheless, he and his neighbours harbour ambitions to invest by

themselves and sell their crops on the open market because of expectations of greater returns as well as the debt risk embedded into the structure of production agreements, one that is commonly found throughout Laos. They dislike the debt they incur when an investor supplies them with inputs on credit. If the farmers have a bad season then the debt for the inputs supplied on credit is rolled over to the following season⁹. The debt is a risk and an obligation which limits that latitude of farmers to decide what to produce and where to sell. Lan highlighted a trader as evidence of the possibility of accessing higher prices. Lan and his colleagues appear to sense rising demand, because of better prices in general and more offers from traders not least those selling into Chinese markets.

Conclusions

- Local investors may have strong social interests, especially reputation, in offering attractive terms to farmers
- Local investors can achieve efficiencies and reliably scale through networks of representatives who know groups of farmers well
- Higher returns¹⁰ due to oligopolies/cartels may be an acceptable price for benefits to the community of stability in terms of reliable



Advertisement of hybrid maize seed in a village in Bokeo

⁹ In practice investors sometimes reduce the rolled over debt notes Stuart Ling, an agribusiness consultant in Houay Xai

¹⁰ Although such returns might be described as rents, particularly if they are protected or facilitated by the state, it may be inaccurate to describe them as rents if the income above the return expected in open market conditions is considered to be a reasonable compensation for the benefits accrued to the community

performance by investors and supply of interest-free credit

- Production agreements may be key for cartels to provide social benefits at minimal cost
- Established investors may be a high barrier to entry by new investors
- Farmers may prefer the risks of producing for open-market prices rather than the risks of debts accumulating when inputs are supplied on credit under production agreements

Success factors

1. Market prices and interest-free credit for household difficulties
2. Social interests, such as reputation, for local investors making agreements with local farmers
3. Network of representatives to work with and manage farmers

Questions

- a. What other mechanisms or factors have maintained the production agreements for so long?
- b. How do the investors cooperate to assign areas of responsibility, set prices and deal with other matters?
- c. What factors determine whether a farmer who has assets to support production employs those assets or enters a production agreement to make use of the assets of an investor?
- d. What is a fair premium for local cartels oligopsonies in return for providing stability, reliability and interest-free credit?
- e. How do farmers perceive and judge the risks of debts for inputs and the volatility or uncertainty of open-market prices?
- f. What do farmers know about trends in demand especially from China?
- g. Should DAFO be doing more for the farmers or are the expectations of farmers unrealistic given resources available?
- h. If DAFO could do more, what assistance could realistically be provided and why isn't that assistance being provided?

8.5. Case 5. Production and sustainability: short-term profits, long-term costs

Ban Nam Buk, TounPheng district, Bokeo



Maize landscape in Bokeo, how long can the land hold?

Commercial arrangements can increase smallholder production beyond the thresholds of ecological sustainability risking long-term decline in yields and incomes

Experience

In a wide flat valley half an hour or so inland from Ban Dai¹¹, beside the Mekong, the road passes through Nam Buk, a village of mostly wooden houses, motorbikes and satellite dishes. With only a few trucks and shops Nam Buk appears less prosperous than Ban Dai. Khampong Khantibanya, head of the sweet potato farmers' group, agreed to discuss farming in the village. The village had obtained import and export permits. However transportation costs and border taxes undermined the benefits of trading by themselves. Farmers instead produced maize and peanut under agreements with Ounhern and Somdee, two of the investors from Ban Dai, between 2001 and 2010.

¹¹ See 8.4

Incomes from maize, which is sold to investors for 3.20-3.30 baht per kilo, have been falling. This year the farmers were unable to repay in full production credit advanced by the investors leaving the balance to be repaid next year. "The price is good, but the problem is the production. One rai can only produce about 250 kilos. In the beginning it was 800 kilos. The land fertility is the only cause I can think of which would reduce production," said Khampong. Farmers applied more fertilizer and rotated maize and peanut to restore yields without success. The future for production agreements for maize is in doubt.

In response to changes in the land and also in demand farmers are now growing an upland variety of native rice. A Laotian Leu came with seven trucks from Muang Sing to buy rice at 10.50 baht per kilo. There was only enough rice to fill two trucks.

Khampong is one of three farmers experimenting with sweet potatoes. The sweet-potato investor told the farmers yields could be of 60 tonnes per hectare, which Khampong expected to provide income of 15 million kip. A brief review of literature and data on the internet during the meeting indicated that while yields of such magnitude are possible they are unlikely without substantial technical support and advanced methods. After considering the new information Khampong explained if his one hectare pilot plot produced at least 8.4 tonnes of sweet potatoes his income would be better than maize.

The quality and quantity of information available to Khampong is inadequate to judge the potential and suitability of new crops and evaluate the claims and promises of investors. Khampong's primary source of information is friends and relatives. Little if any useful information comes from DAFO. "Previously, around ten years ago the authorities visited the village often. It was fairly easy to get the export license from DAFO and commerce. Now we work with investors, DAFO and commerce are paying more attention to the investor and not visiting the village much. A few years ago DAFO and commerce came to the village with an investor interested in tobacco, but nothing came of it," he said.

Nevertheless, Khampong thinks agreements can work if farmers and investors are committed and build trust through their actions and behaviour. "It's about trust, we stick to the agreement. Of course we also have to learn about each other, to tighten the relationship, go for a drink sometimes. As the head of the producer group I can encourage or

inspire the producers to follow the requirements of the investors. This is how we build trust."

Interest in agreements is rooted in their potential to provide a degree of certainty, a safety net. However, aspirations are to farm for themselves for the open market. "The tendency is many people would like to invest by themselves and sell on the open market. However the contract is also good, it can guarantee an income. A written contract could be used to obtain a deposit in advance to give us a guaranteed income if production drops or the investor disappears," said Khampong.

Observations - general

Khampong indicates farmers harbour ambitions to invest by themselves. This may be an unrealistic ambition if the costs and obstacles remain which caused them to cease their own efforts to export to Thailand and enter production agreements. However, if demand from traders is greater now and prices higher because of increased competition then their ambition may be realistic, if they have accumulated sufficient capital to invest in developing their production.

Agreements to produce maize were successful lasting a decade because it was the most attractive option in light of the alternatives and limitations of capital available for investment by farmers relative to the costs of exports to markets in Thailand. Economic interests were sufficiently strong to enforce compliance with the agreement. Khampong, like parties to agreements other cases, emphasized the agreement was supported by webs of trust and reciprocity. Such a social context provides a foundation for an agreement as a means to realize the opportunity. Sweet potato is a new crop for Nam Buk. It suggests demand is becoming more diverse, perhaps a result of better roads, the arrival of mobile phones, and rising awareness among buyers in China seeking to find new sources of supply. Production agreements could help unlock opportunities in new crops to meet the needs of markets in China.

Observations – ecology and sustainability

The production agreement for maize did not end because farmers were able to accumulate the capital and confidence to invest by themselves. It ended because of a decline in yields attributed to deterioration in the fertility of the soil. The

relationship between yields, soil and cultivation practises is a complex phenomenon. In the absence of a technical analysis it is only possible to construct a hypothesis of the dynamics. The general hypothesis is soil fertility declined because the maize variety and the cultivation regime were inappropriate for the environmental conditions. Production was therefore unsustainable. This situation can arise when investors enter agriculture because they provide the resources for production to operate at a greater scale or greater intensity than would otherwise be possible by farmers alone assuming they face limitations of financial capital, technology and market access. The entrance of capital to overcome the existing resource constraints which prevent farmers from developing production in excess of the thresholds of sustainability of the ecosystem is in Laos often facilitated by the production agreement.

The problem with production agreements is an implicit assumption ecosystem functions and intermediate services, such as soil formation, which underpin production will always be available. This may be a reasonable assumption where production does not exceed the thresholds of sustainability. However, where production does exceed the thresholds of sustainability then the agreement as a mechanism to mobilize additional capital facilitates degradation of the ecosystem services, primarily soil, which is a foundation of food security, livelihoods and national resilience. A specific hypothesis therefore is that is production agreements facilitate a higher level of production which in certain contexts exceeds the sustainable thresholds for ecosystem maintenance of soil services.

There are several reasons why production nevertheless proceeded aside from economic interest. One, farmers, and perhaps investors, had insufficient information to select an appropriate variety and production regime suitable for the constraints of local conditions. Two, farmers expected the benefits to outweigh the costs such that by exceeding the thresholds of sustainable production they would accelerate the accumulation of capital as the basis for investing in the formation of an alternative livelihood with greater income potential. Three, investors expected the effects of unsustainable production would be affordable to remediate or that they would be able to access farmers with land elsewhere to make up for the decline in production. Four, farmers and

possibly investors believed, perhaps because they lacked adequate information, that the technology of modern production was sustainable such that traditional systems of production which were sustainable, albeit with lower yields, could be discarded.

If unsustainable production succeeds in generating enough capital for farmers to invest in developing higher-income livelihoods then for them it is a positive trade-off. However, if unsustainable production fails to generate sufficient capital for farmers to transfer into more prosperous and secure livelihoods then the trade-off is almost certainly negative. Moreover, for the country the trade-off is negative regardless of the outcome for farmers because reduction in food insecurity requires preservation of the limited quantity of agricultural land which faces challenges from the externalities of land capitalization including disruption to resource and nutrient flows (Fullbrook 2010, 52, 58, 107).

In the situation of yield collapse while farmers and investors share in short-term distribution of income benefits, long-term ecological costs of depleted soil fertility are borne by farmers and the country. In other words the costs are socialized upon the community of farmers while the benefits are privatized among a few investors. However, the distribution of a decline in production capacity is also shared with investors if they are unable to find other sources of production to replace that lost by fields of depleted soils. Even so, in terms of equity and effects the greater costs appear to be borne by farmers because individually they are poorer than investors. The mobility of capital is such that it may be able to escape the consequences which will reside with fixed assets and labour. The market as currently constructed fails to neither account for these costs nor provide incentives for their avoidance.

If it is technically possible to remediate depleted soil it will require financing. It seems unlikely farmers alone will have access to capital to cover the cost. Remediation will almost certainly require substantial investment by the state, and possibly a contribution from investors either in the form of an administrative charge or in exchange for some sort of exclusive access to the farmers for some years through a production agreement.

Mitigating such a situation in the future may be achieved by several means. One, knowledge and methods can be embedded in production agreements. Two, institutions and organizations

can maintain and nurture the soil, recognizing that individual action may have to be supplemented by collective action to support a common resource. Three, educate and inform farmers to consider the consequences for soil maintenance of a crop and production regime proposed by an investor.

Maintaining production within the sustainable limits of the soil and taking measures to support and nurture the soil may not produce yields of a particular crop type equal to what is possible when production exceeds sustainable limits. Lower, but sustainable yields may undermine the economic incentives for the investor to supply capital through an agreement. Viability will reflect local ecological circumstances, transportation factors, and market regulation. The challenge is to develop sustainable systems which maximize overall yields within thresholds of sustainability. Methods developed and increasingly employed in developing countries around the world (Pretty, et al. 2006) which can sustainably increase overall yields (Altieri 2002, 10, 17, 20, 21) give cause for researching context-specific approaches which will present attractive opportunities to mobilize agribusiness capital in Laos.

Conclusions

- Local investors and farmers willing to invest time and effort to build trust and develop relationships as a supporting framework for the production agreement
- Farmers ambitions to invest in their production may indicate greater demand and competition among traders
- Production agreements can deplete soil fertility in the short-term to increase yields and incomes at a cost of a long-term reduction in fertility, yields and incomes
- Production agreements do not encompass sustainability
- Institutions to regulate production for sustainability are do not exist inside or outside production agreements
- DAFO focuses its limited resources on investors because this appears to be the most efficient way to pursue the government's goal of poverty reduction through increased production
- Farmers inadequate ability to assess agribusiness opportunities can be remedied with training in appropriate knowledge and skills
- Research and development is required to capitalize on the alternatives for developing sustainable, resilient and high-yield smallholder

agriculture

Success factors

1. Trust and relationships
2. Price information to benchmark offers by investors

Questions

- a. What measures could nurture trust and reciprocity?
- b. What alternatives to investors could be developed to supply the capital farmers need to invest in their own production?
- c. How should sustainable production be supported?
- d. What reasons are there for sustainable production issues to be handled inside a production agreement or by institutions outside a production agreement?
- e. What reasons are there for a particular government department or agency, such as DAFO, to be responsible for ensuring sustainable production?
- f. What would be the benefits of making sustainable production practises a condition for registering production agreements?
- g. What would it take to foster user groups, similar to those for water, to manage preservation of the soil?
- h. Why is it necessary for DAFO to commit so much of its resources to investors?
- i. Is it more efficient and effective for DAFO to visit farmers or for farmers to visit DAFO?

8.6. Case 6. Bonded investment

Namor district, Oudomxay



Mr. Houndaeng Paengpajang, chief of crop unit, DAFO Namor

Investment quality is improved when investors are required to assure performance by deposit of a bond with DAFO

Experience

Houndaeng Paengpajang thinks agriculture has a big future. So much so as he tells it he resigned from the police in Luang Nam Tha to study agriculture and return to the government as an officer with DAFO. In Namor, in northern Oudomxay, Houndaeng is chief of the crops unit and also a LEAP coordinator, with a focus on supporting organization of farmer groups and access to finance from Nayoby Bank. In a shared office just before lunch he explained DAFO's role in some production agreements.

DAFO provides several services to investors. DAFO will check for the investor crop suitability and area of lands held by farmers the investor has identified as potential partners. The costs of collecting the data are paid by the investor. DAFO is responsible for drafting an agreement during a meeting between the investor, farmer

representatives and representatives from DAFO, the commerce department and the investment office. "I'm not sure why this role of facilitation is DAFO's responsibility but what I do know is that we are supposed to protect the interests of the farmer so we need ensure what is written in the contract, including for example pledge some money in advance as a deposit at the DAFO," he said.

After farmers have planted the crop the investor is required to place a bond, equivalent to 10 percent of the estimated purchase price, with DAFO. "We want to make sure investors really want to invest in the area which is why we ask for the deposit. It is equivalent to the labour cost. After the season we call the investor to a meeting to check if there are no debts to the representatives or the farmers. If there are no debts we return the money to the investor," explained Houndaeng.

There is also an incentive for the farmers to perform. After harvest farmers receive a fee from investors based on the area of land which was used for production. Investors from China pay 75 yuan, or about 93,500 kip, per hectare.

Houndaeng thinks clear understanding between farmers and investors is an important factor for a successful outcome for a production agreement. "One of the most important things is that if you are a new investor you have to sell your investment proposal to the villagers and understand what they want. This must be clear from the beginning. To judge the investor has good or bad potential we have to look at the proposal, the prices, the inputs, and other aspects of the investment of the business," he said.

Observations

Uncertainty and the potential for misunderstandings may be reduced by the information provided by DAFO, assuming the information is correct. Information on land size and suitability may be useful in helping investors form realistic expectations about the potential yield and returns and in making a reasonable proposal to farmers. Providing clear and accurate information on agricultural production potential is an enabling service might fit DAFO's core expertise but not necessarily its capabilities. Drafting of agreements however may not be a core expertise of DAFO. Whichever agency does undertake drafting it is taken on a responsibility for shaping and recording terms of business which should be equitable, fair and clear in consultation of both

producers and investors. The question is whether the responsible agency is able to do this, assuming it has the capability, if many costs are covered by contributions from investors, as is often the case.

Requiring investors to deposit a bond has several effects. One, deter investors who are insincere or lack sufficient capital to support production and transfer crops to the market. Two, reduce the number of investors competing for farmers but improve the quality of investors. Three, reduce the number of investors making claims on the limited resources of DAFO. Four, reduce the risks of investor failure which can cause enforcement problems and reputational issues for DAFO. Five, farmers and officials may have greater interest and commitment to production agreements because an investor has demonstrated commitment by placing money in a bond. Six, build confidence with investors who do not have local social links or reputation.

The value of the bond was described as equal to the value of the labour supplied by the farmers under the agreement. Farmers and officials may have different views on whether this is a fair estimation of the value of labour, or whether the payment represents partial compensation rather than an accurate insurance for the full value of labour. If it is it may suggest the greatest value a farmer supplies to a production agreement is not labour but land. If the value of land accounts for 90 percent of income due to farmers from the crop under the production agreement farmers might be better off paying labourers to undertake cultivation.

Payment of a fee based on the area of land under production by investors to farmers is not rent because the investor does not gain direct control of the land for the period of production. The fee may be interpreted as a charge for the services of the land. The fee also functions as an incentive bonus because it is paid after harvest. Where production agreements use market prices the land fee becomes more valuable as the market price declines. In that situation the land fee can help offset some of the risk, more so if the agreement does not include a floor price. Payment of the land fee can also be interpreted as a tangible indication of the intent and goodwill of an investor. In that sense, land fees, not unlike bonds, may serve to discipline performance of investors.

Conclusions

- DAFO can provide information to inform better understanding of potential opportunities
- DAFO may support formation of production agreements by facilitating understanding during negotiations – when requested by farmers or investors
- Bonds may deter weak investors and building confidence between farmers and investors
- Bonds may encourage serious investors because they will face less competition from weak investors who can disrupt production and reduce goodwill among farmers and officials
- Bonds may be a powerful tool of economic enforcement
- Bond value may not reflect the full value of labour
- Investors can use land fees to incentivise farmers

Success factors

1. Reduction in uncertainty and risk because of local production information supplied by DAFO
2. Facilitation of understanding between farmers and investors by DAFO
3. Bonded investment
4. Land fees

Questions

- a. What local information about agricultural opportunities can DAFO best provide within the limits of expertise and resources?
- b. What capabilities could help DAFO provide better quality information?
- c. What information and capabilities does DAFO need to facilitate understanding between farmers and investors?
- d. How can bonds be improved, for example through integration with advanced payments?
- e. Where are bonds used and why?
- f. Why are bonds not used more widely, why are they not a universal practise?
- g. Which institution is best placed to hold bonds and under what terms?
- h. What are the implications of land fees and how should the fee be calculated?

8.7. Case 7. Commercial facilitators and transnational production

Ban Khouangkham, Namor district, Oudomxay



Investor collecting water melon for transport to China

Experience

The road north through Namor district from Namor town in Oudomxay province to Boun Dai in Phongsali province winds through low hills quilted with patches of forest amid fields of limey green or loam depending upon the crop. Parked beside a bend in the road was a large truck from China. Boxes printed with Chinese were being loaded into the truck. A few dozen men, women and children, all Laotian Leu, collected watermelons from their fields, sorted them by size, and then packed them into the boxes. Mai Ounseng, a Leu from China, was collecting watermelons too while keeping an eye on overall progress. The work was fast.

Kin ties facilitate trans-national production for distant markets

Every now and then Mai spared a few minutes to talk. Mai was giving advice and instructions to the farmers. In turn he was taking directions in Chinese from the investor, an entrepreneur from Inner Mongolia in the far north of China. When the boxes were packed, the farmers and investor took a break to eat together.

The investor financed seeds and inputs. Mai works for the investor without a written agreement. Mai has written agreements with the farmers. He selects land and provides technical advice to the farmers. He has been organizing production for Chinese investors in Phongsali for four years. Mai thinks the key to successful production agreements is: "...being frank with each other, acting in a transparent way."

This is the first year in Namor, working with eight families he calls relatives who provide 80 mu, or 5.7 hectares, for cultivating watermelons. "We do this because we are working with our relatives, they are farmers who asked us to invest and work with them," said Mai. The key to a successful arrangement is he said frankness and transparency.

The watermelons were being shipped, at 1,000 yuan per tonne, directly to Inner Mongolia. Once there a box of four watermelons sold for 50 yuan. In the fields of Namor the cost was 13 yuan¹².

Observations

Farmers asked Mai to facilitate the production. This may indicate he had a reputation which inspired confidence of a successful outcome. Mai's reputation may reflect his involvement in similar arrangements in Phongsali for four years. So although this is the first year for a production agreement for these farmers, there is a background of success.

Mai highlights transparency as a key factor for successful agreements. A written production agreement provides a clear record contributing to greater transparency. It is also a prerequisite for registering the arrangement with DAFO. Trust is important too. The farmers and Mai are related, perhaps very loosely. But nevertheless they are not quite strangers and are able to find out reputations through networks of family and friends. This may provide a degree of social enforcement to complement economic enforcement of an attractive arrangement. Mai also works with



Mr. Mai Ounseng, an investor keeping an eye on overall progress

¹² For a comparison of price in Beijing see appendix

the investor based on trust because their production agreement is verbal.

The production agreement depends upon Mai as a comprador. He facilitates the arrangement with his command of Chinese and Leu and ties to Leu communities in Laos. With his language and local knowledge and connections Mai provides information and channels to match the land and labour of the farmers with the inputs, technology and market of the investor.

Mai fulfils a similar role to the organizations facilitating opportunities between coffee farmers and buyers in case 1. The difference is those organizations are public-interest facilitators whereas Mai is a commercial facilitator operating for profit. It may be that commercial facilitators are or will be more common, especially where demand is increasing from many markets as is the case with China. Commercial facilitators present a risk of acting to maximize their interests over those of farmers. They may restrict information or attempt to exert a monopsony. Family and reputation might moderate such impulses. Also the increasing flow of information through mobile phones may help discipline the performance of compradors. It was one of several instances encountered of entrepreneurs from northern China investing in production in Laos in lands close to the Chinese frontier via the enabling services of Chinese Leu. It illustrates links with distant markets and the attractiveness of Laotian production for investors from places which may face insufficient local production or climate and seasons quite different to Laos. In these situations production agreements realize transnational opportunities.

This case bears comparison with the watermelon case documented in Muang Sing, Luang Nam Tha province (Fullbrook 2007, 30-32). Production there was through verbal agreements between relatives of an extended Leu family spanning the border. Relatives in China provided the investment and market for relatives in Laos providing land and labour. Technical support was by a consultant from Zhejiang province, next to Shanghai. Watermelon trade was facilitated by local border arrangements. The kin ties in the case of Namor are looser than in Muang Sing, yet they are still a factor for building confidence, mediating information, and connecting assets of the investor with assets of the farmers. In Namor a written production agreement formalized the relationship, obligations and expectations suggesting perhaps that production

is becoming more formal, that all parties are seeking clarity as a basis for understanding and to reduce the risks of problems arising. As with the case in Muang Sing local authorities, such as DAFO, had little, if any, constructive involvement, illustrating how an investor and farmers can very well work out production agreements by themselves.

Conclusions

- Production agreements can supply transparency
- Production agreements can be arranged without involvement of local authorities such as DAFO
- Extended families and ethnic kinship foster confidence to make production agreements
- Production agreements may be increasingly initiated by commercial facilitators, especially those who speak several languages, who are matching farmers and investors
- Laotian farmers can produce products for sale to long-distance fresh markets
- Production agreements may become more common if demand continues or increases for fruits and vegetables from markets in northern China
- Opportunities for Laotian farmers and Chinese investors may grow because the tropical seasons and conditions of Laos are complementary to semi-arid northern China



Watermelon packed in boxes for Chinese market

Success factors

1. Trans-national language, family and ethnic ties
2. Increasing trust and transparency with written production agreements
3. Commercial facilitator
4. Highly complementary places of production and consumption

Questions

- a. Is the agreement registered and what was the role, if any, of DAFO?
- b. What value could DAFO's participation add where social enforcement supports the relationship between the investor, facilitator and farmers?
- c. Why should DAFO be involved in negotiating market coordination arrangements between an investor and farmers?
- d. What controls, quotas or support by the Chinese government shape the interests and behaviour of entrepreneur investors from places in China far from Laos?
- e. What products can farmers in Laos competitively produce for urban markets in China?
- f. How can farmers exert influence to ensure compradors facilitate the best offers?

8.8. Case 8. Policy and practise: practical limits and the efficiency of commerce

Kum Ban Khouang, Namor district, Odoumxay



Investor and farmer jointly inspecting cabbages in the field

Experience

Kumban Khouang is a group of seven villages spread across plains and gentle hills of a valley about half-way between Namor and Boun Dai. Most of the houses and buildings are made from wood. Khamsau Sinyawong is chief of the kumban, the administration which oversees the villages of Khouang. Sometimes the kumban helps farmers and investors negotiate production agreements. But there is only so much the kumban can do with its limited resources.

Sitting outside the old weather-worn clapboard hut which is the office for him and a few village constables he described some of his experiences. "We are involved in supporting the organization of farmer groups and in some cases screening of

Commercial arrangements avoid inefficient administrative controls, rules and regulations

contracts. Most of the investors coming here are Leu, they are family, they know each other," he said.

There are limits however to the scope of involvement of the kumban in production agreements. Farmers and investors often want to get on with their business without the kumban.

"We would like to inspect and monitor the contract, but usually we don't receive good cooperation from the village. For example, the villager responsible for economic affairs isn't very cooperative. Often they are involved in the contract as a middleman. The income to the village is hard to monitor for tax purposes. The investor will say he's paid to the village. The villagers will say they haven't been paid. There are too many investors and middlemen. Each has their own channels. Sometimes the village chief or party members are unaware villagers are working with Chinese investors," said Khamsau.

Informing the authorities of their business can be time-consuming and costly for investors. For some it is cheaper and simpler for their business to avoid state agencies where possible. "Some investors don't want to make the contract official because it is time consuming and cost various fees. They also have to follow up within individual departments after the joint meeting for additional papers and approvals. If they had to pay something they would rather pay to a single door. The investors without a contract just pay once [to customs' officials] at the border," he said.

Khamsau thinks crops not produced under agreements registered with DAFO are nevertheless finding a way around border controls to be exported. Trade is vibrant. "According to the DAFO regulation on contract farming customs should only allow products produced under contract farming to be exported. However in practise it is difficult to enforce," he said. "I'm not sure if the enforcement of the contract regulations is strict enough because a lot of exports seem to happen which don't have contracts and aren't subject to fines."

A production agreement is only recognized as a contract if it is written, specifies a price and is registered with the district authorities in Namor. The kumban and other agencies are supposed to only mediate disputes between farmers and investors if their agreement is registered as a contract. "When there was a problem we brought everybody together to discuss it. It was very hard to solve the problems. The investor complained. The producers complained. It is a weak point that we didn't know

what happened actually."

There have only been several disputes yet there have been dozens of production agreements during recent years. Khamsau estimates half the farmers in the seven villages are involved in production agreements. He said in most of the successful cases the investor and farmers knew each other, the investor worked through a representative, and bought the entire harvest.

Observations

The kumban would like to monitor all production agreements which should also be registered with district authorities, especially if the product is for export. This is not happening. There are almost certainly far too many production agreements for the kumban to comprehensively monitor and review. Moreover most production agreements appear to have a satisfactory outcome for farmers and investors without support or involvement of the kumban or DAFO. In the few cases where a dispute was presented to the kumban for mediation there have been considerable difficulties to resolve.

There are several reasons why state officials face limits in their role in supporting contracts. One, their training may not have provided sufficient appropriate knowledge and skills, such as for example rewriting agreements to eliminate vague or disputed terms. Two, state budgets may be insufficient to support frequent observation of field conditions, crop development and contract drafting. Three, personal interests may compromise their ability to comprehensively implement regulations and provide neutral arbitration.

The costs of the registration of production agreements in time, fees, taxation, and possibly unofficial charges exceed the value of the benefits of registration such as legal compliance, export permits and access to official mediation. It is almost certainly faster and probably cheaper for investors to pay a single fee to customs when they export products bought from farmers under production agreements.

Kumban, DAFO and other district authorities appear to lack the capacity to monitor all production activity and also to enforce compliance by investors and farmers with all regulations, especially regarding registration. Were they to try to do so they would probably be unable to perform other duties and may reduce investment and production reducing

prospects for alleviating poverty.

Coordination issues would not be an unusual problem between government agencies, particularly customs and DAFO. They are also competing in terms of services they offer for fees to facilitate exports. From an investor's perspective paying one fee, whether formal or informal, to customs may offer better value in terms of efficiency versus cost. The lower cost offered by customs improves the competitiveness of Laotian farmers because it contributes to reducing the overall costs faced by investors when evaluating investment opportunities.

Nevertheless some production agreements are registered. This may happen when farmers and investors lack confidence, perhaps because they are unfamiliar with each other or are unable to check reputations. Registration may raise confidence, improve transparency and provide access to administrative enforcement.

Conclusions

- Farmers and investors can arrange production agreements with acceptable outcomes without involvement of kumban or DAFO
- Most production agreements do not require any assistance from kumban or DAFO
- Kumban and DAFO may lack the budgets, capabilities and motivation to comprehensively monitor and support production agreements
- Farmers and investors may perceive little value in the services of state agencies which as a result they try to avoid
- Poor coordination and facilitation competition between state agencies may result in lower costs and more efficient export services for investors
- Investment in production agreements is more attractive when competition between state agencies to provide facilitation leads to lower costs and greater convenience for investors
- Simpler methods of tax collection are necessary because current arrangements can be evaded by the innovations of farmers and investors
- Overlapping mandates of state agencies while inefficient may leave opportunities for farmers and investors to react relatively quickly and efficiently in response to market conditions

Success factors

1. Social links between farmers and investors
2. Competition between government agencies

Questions

- a. What roles or services can kumban and DAFO perform well within the limits of their budgets and capabilities?
- b. What roles or services do farmers and investors need from the kumban or DAFO to support production agreements?
- c. Why is contract registration inconvenient for farmers and investors?
- d. How could registration be made convenient for farmers and investors?
- e. What positive incentives could be provided to encourage registration of production agreements?
- f. What alternatives are there to registration of production agreements?

8.9. Case 9. Information and negotiations, risks and obstacles

Ban Hon Doy, Boun Tai district, Phongsali



Mr. Souk produced soybean under agreement

Farmers can use agricultural markets information to negotiate better bargains with investors despite shortcomings of DAFO

Experience

In neat fields between a small river and the dusty road north from Boun Dai farmers, some wearing baseball caps or conical hats, were tending small light-green plants of soya bean. Among them was their leader Souk Saenyawong. In an old sala he discussed how farmers were working with a Chinese investor, who like themselves was a Leu.

In 2010 the investor first made an agreement with DAFO in Boun Dai and then visited the village to meet farmers. Souk first met him when he was head of Sinsai village five years ago. A few years later Souk worked with the investor to facilitate investment in rubber in the district. During the meeting the production agreement was read to farmers. Some farmers agreed to grow chilli for the investor with Souk as their leader and technical

adviser. However, the farmers felt the labour input was high so this year they agreed with the investor to grow soya beans instead.

The farmers negotiated themselves with the investor. Information was a problem. "We read the contract and wanted to change the price which was 1 yuan per kilo. We wanted 1.5 yuan per kilo. DAFO didn't know the market price in China and didn't help us negotiate. In the end we agreed 1.2 yuan per kilo," said Souk. "We expected DAFO to know something about the price because they introduced the investor."

The investor provides inputs and some fuel for water pumps for free. When the investor pays the farmers for the crop no deductions are made for inputs. The investor also pays farmers 50,000 kip per mu for the season.

"Paying for the land seems to be common practise among Chinese investors. This was proposed by the farmers, based on what they learned in China. There the fee is about 100,000 kip per mu," said Souk. "The district and province thought that was too high, they decided the fee should be 50,000 kip per mu. The district and province fear if farmers get a higher fee they will lease all the land to Chinese investors, even land in which the government has invested in irrigation for rice."

Farmers in Sinsai are working with the investor despite having enough capital to invest in their own production. "The problem is we don't have the technical knowledge, especially using fertilizer and pesticide. One of the issues is all the information on the inputs is in Chinese which we can't read," said Souk.

Technical knowledge can be learned through experience. Obstacles to accessing the market are harder to overcome. "It is difficult to find the market if we invest by ourselves. It is hard to sell in Laos. When we have tried to sell in China we faced difficulties. Chinese buyers often said our products were no good. They can say whatever price they like if we sell to the open market¹³. If we have an agreement it is easy to negotiate if there is a dispute," said Souk.

Although farmers have been making production agreements with investors without much support from DAFO, Souk thinks DAFO could help in several ways. "One, they should negotiate better prices with the investors. I suppose for better negotiations DAFO should have market information from the Chinese side. Two, we need technical support from DAFO. Recently we mostly relied on the technical support from the Chinese side. We follow their guidelines but how can we know if it is the best way to improve production?" In general the policy of the government is to encourage people to grow cash crops to reduce poverty. But in practise they don't work closely with the farmer."

Observations

Farmers expect support from DAFO on three issues. One, assist them with negotiations, either by supporting their position or by undertaking negotiations on their behalf. Two, provide technical and market information. Three, authorize investors and their proposals.

Despite DAFO's shortcomings in negotiation and information perceived by farmers they nevertheless managed to reach agreement with the investor. They negotiated a higher price and they also proposed a fee for the land. The price and the land fee were based on information they had acquired during their visits to China or through networks of friends and relatives. The farmers expect DAFO to perform tasks they adequately performed themselves. This can be interpreted in several ways.

One, farmers perceive a relationship or power distribution in which it is the role of the DAFO to provide market information and technical direction, a form of dependency or paternalism. Farmers have demonstrated however that they can acquire some information and negotiate a better deal. Their weakness is insufficient skills to acquire adequate information and inadequate knowledge to fully understand and interpret market information. Sufficient information and adequate knowledge would make strengthen their position in production negotiations. DAFO's capacity to acquire and interpret market information is unproven and were it to exist it would probably be a feature of its services. That information provision is not a common service of DAFO suggests the capacity is weak or absent. The case for DAFO to direct its limited resources to assist farmers in matters they can do themselves, perhaps with some advice or training, is therefore weak. A role which may be performed

¹³ Investors may also dictate prices regardless of the production agreement when produce is delivered to the border as has happened to farmers producing cabbages and other products in Champasak and Salavan (Fullbrook 2007, 44-47)



Soybean produced under agreement

within the limits of the capabilities of DAFO is determining the optimal crop for local conditions and providing technical information on the most efficient methods for maximizing yields.

Two, farmers feel disadvantaged because of they do not have sufficient technical knowledge for new crops. A reason for entering production agreements is the supply of technical knowledge. The deficit in technical knowledge could be rectified with the experience of a few years of production. Technical knowledge is therefore an ephemeral problem.

Three, farmers may not feel confident enough to act by themselves and take responsibility for their actions or would rather shift responsibility, and liability, on to DAFO. If there is a dispute with an investor they are working with then the farmers may feel they have a right to expect DAFO to resolve the problem or compensate them in some way. Whether DAFO could do much in practise is open to question given the limitations it has demonstrated to farmers. Farmers are using DAFO as a solution, albeit imperfect, to the absence of effective legal enforcement, the risks of working with foreign investors, and the difficulties of conducting due diligence on some foreign investors.

Four, farmers may think having DAFO visibly working with them to make the agreement with the investor will redress power asymmetries in negotiations. In directing investors to DAFO before commencing negotiations for a production agreement the farmers may on the surface be following regulations or deferring to the perceived authority of DAFO. They may however be shifting a degree of responsibility for the investor's performance on to DAFO. Sending investors to DAFO may also function as a filter mechanism. The costs in terms of time and money in dealing with DAFO and other authorities may serve to dissuade and filter out investors with weak commitment or capabilities.

The underlying or longer-term problem is market access which may be due to several problems. One, farmers face monopsony. Two, farmers have not met buyers from complementary, probably distant, markets where demand elasticity is relatively low because of substantial differences in purchasing power¹⁴. Three, they have a weak bargaining position

¹⁴ See appendix for indicative price differentials between the farm gate in Laos and retail in Beijing

when they present crops for sale at a market in China. Four, their volumes may be insufficient to interest buyers who value quantity and security of supply over price. The production agreement helps farmers overcome the obstacles by dealing with the investor in a transparent arrangement. The production agreement is also valued as a reference point for resolving disputes.

Resolving disputes may require assistance from DAFO. However, it is unclear whether DAFO could perform in this regard and whether it would be neutral. When farmers proposed a land fee of 100,000 kip per mu, DAFO was able to impose a fee of 50,000 kip. DAFO therefore can exercise authority, in this case apparently to preserve land for local food production. However, by imposing a lower fee DAFO was reducing the income of farmers and therefore prospects for reducing poverty while providing a benefit to the investor. Imposing a lower fee demonstrates DAFO has power. That power could be used to preserve food security, instead of suppressing the income of farmers and cutting costs for the investor, by enforcing reservation of land for local food production.

Conclusions

- Farmers can acquire information and successfully negotiate with investors
- Through experience farmers may overcome weaknesses in technical knowledge
- Production agreements are most useful for farmers as mechanisms to overcome risks and obstacles to market access
- Farmers use DAFO for risk mitigation because of insufficient information and enforcement challenges
- Farmers engage in strategies of risk reduction and responsibility shifting by sending investors to DAFO for authorization
- DAFO could support farmers and production agreements with technical assessments to match crop varieties and cultivation methods with local conditions to maximize output
- DAFO lacks the will or capacity to provide sufficient market information
- DAFO is unwilling to become involved in negotiations by farmers with investors – either to remain neutral or reduce perceptions of liability
- DAFO lacks the capacity to manage trade-offs between food security, poverty reduction and investor interests

Success factors

1. Market information for production-agreement negotiations
2. Recognition of production agreements as an efficient mechanism to overcome obstacles to market access
3. Production agreement provides transparency
4. Land-use fee as an advance and expression of investor commitment

Questions

- a. Why did DAFO impose a lower fee for land use to preserve land for local food production instead of reserving some land for local food production?
- b. Why is a lower rate for the land-use fee in the interests of farmers and poverty reduction?
- c. What knowledge do farmers need to improve their understanding and use of market information?
- d. What roles should DAFO focus on?
- e. How can DAFO refocus its resources to perform fewer roles better, particularly matching crop varieties and methods to the limitations of local conditions?

8.10. Case 10. Investor competition for farmers

Ban Yoo, BounNeua district, Phongsali



Investors collecting pumpkins for export to China

Fraternal networks can facilitate trans-national production with foreign investors in ways which are more productive than investors promoted by DAFO

Experience

Down a leafy track a few dozen Leu farmers were gathered around a large truck from China, sitting and standing, talking and joking. In the middle of them beside the open back of the truck was a large set of scales. A man in straw hat with a wide brim reading the scales as a farmer loaded on his sacks of pumpkin was Kham Daet, a Leu comprador from just over the border in China.

He was expecting 600 tonnes of pumpkins from farmers he has production agreements with in several villages. The harvest came in around 120 tonnes. "Based on the area of land the production should have been okay, but the seed quality was not as good as we expected. Next year we will change to a better variety," said Kham. The harvest fills about

four trucks, each carrying up to 33 tonnes. Still, pumpkins are not all that he is facilitating. He had already sent ten trucks of long pumpkins grown under production agreements to northern China.

Sitting nearby in a blue shirt recording the transactions was Jansee, who has only one name. He works for Kham providing technical advice and helping to organize farmers in his village Xiangbi. "Kham came to ask me to find as much land as I can. He also asked me to look over the production, technical support for the farmer. I called to China to speak with Kham's technical expert for advice. Kham sends the inputs to the border where I pick them up. We have permits from DAFO to cross the border to pick up the inputs," said Jansee.

Although the fixed-price production agreements began in 2009 Kham's interest and friendships in the area go back some years. "In 2000 Laos was opened for Chinese to invest in this region. Kham was thinking about what he could do. First he came to buy rice. About two or three years ago he bought long pumpkins. Last year he came to invest," said Jansee. "Kham didn't invest by himself. A trader from Sichuan Province of China came to invest the money and supply the inputs."

Investment and production is expected to expand in the years ahead. "We would like to make longer-term arrangements in Laos for products like pumpkins with strong demand in China," said Kham. "There's not enough land in China, people prefer to use the land in Mong La¹⁵ to grow bananas."

Investors are coming from big cities across inland and northern China, where the climate and seasons are quite different to tropical Laos. "Actually investors and traders mostly from Beijing, Shanghai, Chengdu, and some from Shandong, Tianjin, Chongqing¹⁶, first came to Mong La to order products around five years ago," said Kham. He sees more investors coming every year.

There are also traders who send their own agents like Xinhuang Huanda, also a Leu from China, who is sitting chatting, joking and smoking with the farmers. He represents traders from big cities across northern China who arrives each season in Bohan, just over the border, to buy. Xinhuang is looking to



Collecting pumpkins to transport to market

¹⁵ Mong La, or Meng La, is a country in the Xishuangbanna, or Sipsongpanna, Dai Autonomous Prefecture, Yunnan Province, China

¹⁶ These cities are roughly on or north of the Yangtze River in China

buy pumpkins not covered by the agreement. Farmers say they won't sell to him because they respect the agreement and face a fine if they break the agreement.

The production agreement is endorsed and signed by the farmers, Kham, DAFO and other local agencies. There are several reasons for the production agreement. "We don't have the capital to buy the seeds, the inputs. We use our capital to invest in other crops, those we feel more certain about such as beans, maize, garlic and onion," said Dan, a farmer with only one name.

Jansee points to issues of investor integrity, risk and market access. "One, to stop investors coming and leaving, misleading us and leaving us with product we can't sell. Two, accessing the market in China can be difficult. There are transport costs, the problems of dealing with customs and border facilities. Having a contract makes it simpler for us, we can be fairly sure of the market. Kham deposited 20,000 yuan with the district authority. If there are any problems this money provides us with some compensation. And if there's no problems the money is returned to him," said Jansee.

For farmers in the district getting permission to export from Laos is hard. Jansee pointed out costs are lower in Namor and Ou where district authorities impose only a small fee on exports and take actions to reduce obstacles. "We have established our group in the village. We could not get the signature for the district and province for the export of the product. I assume this is because some company has some arrangement with the authorities to prevent other businesses becoming active," said Jansee. "We would like exemptions on export taxes. Now farmers have some capital to invest themselves, but the export taxes make it hard to make a profit. Every time we meet with officials we emphasize this."

Investors also need an agreement to obtain assistance from the government and work within the regulations controlling production in the area. "Nobody will listen to you without an agreement. The authorities will not help us without an agreement. In China regulation is stricter than here, we have to register agreements with the court," said Kham.

Investment in the area is controlled. Two investors from China have rights of access and export. However the rights are not exclusive because Kham is able to invest too. For the first two years he could

export. For 2011-2013 Kham has to pay 1 jiao per kilo of pumpkin to the Cash Crop for Livelihoods for Export, which is one of the approved investors from China. Jansee said the business of the Cash Crop for Livelihoods for Export has not gone well. He expects many of the farmers locked into agreements with the Cash Crop for Livelihoods for Export to switch to Kham when their obligations expire in 2012.

They all emphasize mutual understanding as critical to working together successfully. "The key thing is to understand each other. We can develop our understanding through discussion, we can raise our problems, he can come to us when he has difficulties," said Dan.

Honouring the terms of the agreement is also important. "When there is a fixed price both parties should stick with it," said Jansee, the representative. Kham, the comprador from China, added: "If the price goes down, we will lose but we're still happy to pay because we already agreed the price in the contract. We want all parties to act fairly."

Developing the relationship is another factor. "The other thing is rewarding the farmers, for example I have experienced investors who after selling the products in China bringing will bring a pig to the village to celebrate," said Jansee. Flexibility and accommodation also help. "We try to satisfy them in terms of pricing. For example this year it is one price, the next year we try to meet the farmers' demands for a higher price," said Kham.

Understanding, awareness and accommodation are helped by the social context. Jansee first met Kham when he went to Mong La two decades ago to buy things for his family. Dan met Kham at a market in Ban Yong a decade ago. When the weighing and packing is done lunch is put out on a mat in a hut which happens to be the base for a lonely young soldier charged with providing security in the area. Kham, Jansee, Dan, Xinhuang, other farmers, two women who are traders travelling with Kham, and even the soldier, eat and chat.

Observations

Buyers from China are competing for the services and crops of the farmers. There are two primary investors, including Cash Crop for Livelihoods for Export, approved and supported by DAFO. Kham represents a secondary investor with fewer rights than the primary investors. There are also traders. Farmers appear well aware of the strength of demand and

the plurality of competition among buyers from China. Kham appears to offer better terms in the production agreement than the primary investors. Investors need production agreements to secure supply and counter competition. Farmers enter production agreements to protect themselves from default by insincere or weak investors and also to overcome obstacles to market access.

Farmers and Kham's trust and confidence in the production agreement draws on relationships and reputations which go back many years. The social context enables representatives of farmers and investors to find each other more efficiently and have a deeper understanding of each other's needs and interests. They all emphasize the importance of understanding as critical to maintaining a good relationship as the basis for cooperating through the production agreement. Kham blamed a poor yield not on the farmers but on the seeds. This might be interpreted as an indication of the level of trust and the interest from the investors in building a relationship with the farmers. An investor with different interests might have blamed the bad harvest on the farmers and sought redress from DAFO. Both sides also have their reasons for seeing the production agreement registered with DAFO.

DAFO supports the production agreement by providing an administrative basis for investment, export and enforcement which is recognized, accepted and perhaps valued by farmers and investors. The quality of the service however may be below expectations. DAFO is, in the view of the farmers, also obstructing their efforts to export directly to markets in China. Just how practical that is may vary according to crop, season and demand. Nevertheless, the disappointment of the farmers indicates either a lack of understanding between the farmers and DAFO or might indicate contradiction and confusion about duties and interests within DAFO.

Whatever the reasons for controls on investment, dividing investors into classes of primary and secondary, the outcomes appear to be poor in terms of improving livelihoods for farmers. A more effective investment regime may be a simpler one which permits any investor who meets certain criteria and deposits a bond with DAFO.

Conclusions

- Farmers and investors prefer agreements for organizing production
- The social context supports trust, confidence, understanding
- DAFO can provide valuable services supporting formation of production agreements, and especially managing assurance bonds from investors
- DAFO can also obstruct the interests and aspirations of farmers for direct exports and trade with buyers in China for some crops
- Policies to favour some investors may be counterproductive in terms of production arrangements and income for farmers
- Demand and competition from China is favourable to farmers in Laos and better production agreements

Success factors

1. Strong interest and appreciation of production agreements by farmers and investor
2. Social context and commitment to understanding and developing relationship between farmers and investor
3. Investor performance bond deposit with the local authority
4. Complementary production and consumption between Laos and some markets in China

Questions

- a. Why has at least one of the primary investors favoured and supported by DAFO been less productive and effective than the secondary investor Kham?
- b. How does the investment regime which gives privileges to selected investors reduce poverty and benefit the livelihoods of farmers?
- c. Why are farmers unable to obtain export permits and negotiate lower export taxes?
- d. What services should DAFO focus on and how can its performance and delivery of those services be improved?

8.11. Case 11. Investors and traders

Ban Nam Daengkang, Luang Namtha



Mr. Kham Sayasan produces maize under production agreement as well as for open market

Farmers can improve livelihood security and reduce risks by splitting production between investors and traders

Experience

Kham Sayasan lives in a small bungalow built from wood wedged in between the road from Luang Nam Tha to Boten and the steep hillside running down to a small river. In the back of the gloomy bungalow is a television, a bed, a mosquito net and a few low stools and a table. He keeps the front of the bungalow open as a shop for passing trade. Neatly laid out for sale are garish packs of processed food and household products, cigarettes and drinks from China and Thailand.

Kham is not only a shopkeeper however. He has also been farming maize under production agreements since 2007. Kham estimates he farms 5 rai because he uses 15 kilograms of seed, which is applied at 3 kilograms per rai. His yield is about 2 tonnes per season. He was a latecomer. Friends and neighbours began in 2005. "If the majority in the village are working with the investor the others feel they should be too," he said.

Farmers first made production agreements to reduce risk. "There are two reasons for the agreement. First, is because of the uncertainties of just dealing with traders. Second, is to reduce betrayal by investors because we already have experience of that, forcing us to sell at 500-600 kip per kilo after the maize price fell," said Kham.

Competition for maize is strong. "The numbers of buyers has not changed much. There are two traders and one investor plus the investor introduced by the government. The quantity being produced has risen and the investors and traders buy all of it," said Kham. "In general in this village the area of agricultural land has not increased but the area under maize has expanded."

There are three offers for the farmers:

- Chinese entrepreneur investor: seed + some pesticide + a market price + interest-free credit
- Investor introduced by DAFO: seed + pesticide + fixed price
- Traders: spot price

Farmers prefer the Chinese entrepreneur investor because the price is good and credit is available interest-free after the crop has been planted, or charged at 10-15 percent before planting. Inputs are supplied on credit. The investor's representative signs a market-price agreement with the village head who makes a verbal agreement with the farmers. Agreements for credit are also mostly verbal. Many farmers borrow after planting as they see it as an advance.

Farmers have not entered production agreements with the investor introduced by DAFO because the fixed price is low and credit is not available.

Farmers often only sell around half the harvest to the Chinese entrepreneur investor. The remainder is sold to traders, who drive around with ten-wheel trucks buying whatever maize is available. Kham thinks the investor is unaware farmers are splitting the harvest with traders despite regular visits from the representative. "The representative often comes to talk with the farmers and every time he comes he gives us notice he will come and we make sure we are around to see him. If there are any problems we discuss then," said Kham.

So far the production agreements have been successful, despite the farmers selling to traders. "If [problems] really happened we would have to sit and discuss, to read through the agreement again. We would have to observe the reaction of the buyer to decide what measure we would try to apply. So far we don't have this experience. However, demand is quite high so if there is a problem with the representative we should be able to sell to the traders," Kham said.

He expects the production agreements to continue. "In future it depends upon the situation. For example, if there are investors who offer good terms we will go with them. As for my own investment, well it depends if I can save enough money."

Observations

The agreement for production is often interwoven with other exchanges of interests and incentives. The investor supplies the farmer with two forms of credit. One, inputs. Two, cash. Both are secured against the value of future output under the production agreement. Advancing two forms of credit to farmers is a risk for the investor. It demonstrates confidence in the farmers and per-

haps also the ability to enforce and recover credit. For the farmers the cash loan functions as an advance payment and compensation should the investor fail to buy the maize. Credit may also function as a mechanism for building farmers confidence in the investor. The investor may also be demonstrating confidence in farmers by advancing interest-free credit once the crop has been planted.

The investor invests capital to supply inputs to farmers. The supply of inputs enables farmers to overcome their own capital constraints, or focus their capital for other purposes. The inputs however are not used to produce maize exclusively for the investor. Instead the farmers split the crop between investors and traders. The investor is effectively financing production of supply for the trader and the continued existence of the trader as competition. By selling reasonable volume to both the investor and traders the farmers are ensuring both types of buyer can survive, that it is economical for them to continue buying from the farmers, and in doing so perhaps provide an element of competition, especially if they are feeding into different supply chains. The competition between the investor and traders may improve terms in the production agreement for farmers and perhaps also the investor's tolerance for farmers selling to traders.

Kham thinks the investor is unaware of farmers are splitting the crop with traders. He may be right. However, if it is assumed the investor has estimated the output for the seed type in local conditions then the investor should notice the discrepancy between the estimate and the amount offered by farmers. The investor may accept sales to the traders by the farmers as the price of building a long-term relationship with the farmers which may be an obstacle for competitors. Even after sales to the traders, the volume of maize left must be sufficient to make the production agreement viable for the investor.

The investor might conceivably lack sufficient capacity to buy the rising output from farmers. Traders step in to buy and store maize for the short-term until the investor is ready. Traders sell the maize for a higher price to the investor. The difference is not only the profit for the trader, but it is the cost the investor pays for the trader to supply short-term credit and storage.

This case is unusual because the farmer admitted crops produced using inputs supplied by an investor under a production agreement were also being sold to traders. This may not be uncommon. Farmers often mention the presence of traders but deny that they sell to them. Traders would soon be out of business if they visited places where they could never buy crops from farmers primarily producing under agreements with investors. Another possibility is some farmers may not commit all their fields to production under agreements.

The investor introduced by DAFO is rejected by the farmers because the price is low and the credit is not offered. This is a poor quality opportunity. It does not reflect market conditions. It seems likely to do less to improve the incomes of farmers, reduce poverty and increase prosperity than the opportunities offered by the Chinese entrepreneur investor or traders. If DAFO is unable to introduce high quality opportunities to farmers it may be a sign that it should focus its resources elsewhere and leave the market, with appropriate regulation, to provide opportunities.

Conclusions

- Competition supports better terms in production agreements for farmers
- Interest-free credit is a mechanism for building confidence in a production relationship
- Interest-free credit is an advance which offsets production risks with investors for farmers
- Interest-free credit may be easier for investors to recover if farmers break the production agreement because it is a debt not an advance
- Farmers can support competition and insure themselves against buyer failure if they supply crops to investors and traders
- The government's goal of reducing poverty among farmers will not be achieved if DAFO introduces uncompetitive investors to farmers

Success factors

1. Strong demand and market open to competition between investors and traders
2. Market price and inputs and cash supplied as credit

Questions

- a. Why did farmers decide to split output from production financed by the investor between the investor and trader?
- b. How do farmers perceive their relationships with investors and traders and the relationship between investors and traders?
- c. If farmers could access credit from other sources how would that affect their relationship with the investor?
- d. Why is DAFO introducing an investor with an uncompetitive offer?

8.12. Case 12. Reputation matters

Ban Phiengxai, Boun Neua district, Phongsali



Tea planted in an upland village

DAFO is powerless when an investor absconds leaving farmers without a market

Experience

Between the dirt road and a river in a verdant narrow valley on the way from Boun Neua to the Chinese border is Phiengxai, a village of stilt houses packed tightly together. In the mid-afternoon as villagers were walking down to the river to catch fish Khamtoun Maosaengsansat in the shade of a hut used for village meetings to talk about DAFO and a tea investor from China.

In 2005 DAFO introduced an investor from China who wanted to produce tea with the villagers. The farmers were assured by DAFO the investor would return to purchase the tea. The agreement,

written in Lao and Chinese, was read out to farmers and they could also read it for themselves. The investor, the village head and DAFO signed the agreement. Khamtoun joined the production agreement and received 5,000 tea trees from the investor. In 2010 it was time to harvest the first crop. The investor however did not return to buy the leaves.

The villagers felt DAFO was responsible for the investor's failure. After a meeting the villagers asked DAFO to buy the tea or find a new buyer. DAFO advised the farmers to sell the tea to traders. "I lacked the capital to invest by myself. However the investor hasn't bought the tea. But we can sell to the traders who come around the village," said Khamtoun. This year he has not harvested the tea because he has been too busy with passion fruit.

Observations

Although this case is not a success it illustrates DAFO cannot enforce agreements it brokered with foreign investors by administrative or other means. The farmers see the investor failure as a responsibility of DAFO, a view supported by strong assurances the investor would return to buy the crop. DAFO's remedy was to tell the farmers they could sell the tea to anyone. That remedy is the default for farmers. They did not need DAFO's permission to sell to traders.

The farmers are disappointed with DAFO. The failure could be for several reasons. The investor may have been well intentioned but fallen victim to unexpected difficulties. Or the investor may have been insincere or found more lucrative opportunities elsewhere. Whatever the cause and no matter how good DAFO's judgment the investor still failed. The failure and in the eyes of the farmers responsibility is linked to DAFO because DAFO introduced the investor. The failure also shows DAFO is relatively powerless to enforce the performance of investors or obtain compensation. In case 11 DAFO introduced an investor offering a poor deal compared to the Chinese investor entrepreneur. There the farmers were able to decline the offer because of competition between buyers.

Being associated with investment failure or poor-quality investment offers damages the reputation of DAFO. Farmers may be less receptive to further efforts by DAFO to broker agreements with investors. Farmers may instead prefer to make their own agreements, which as a process will reduce

space and relevance for DAFO in the production opportunity between farmers and investors. DAFO has to provide services which it can perform consistently to a high standard if it is to be welcomed and valued by farmers and remain relevant to their needs and interests.

DAFO's reputation and relevance may have been supported had it taken a performance bond in advance from the investor. This bond could then have been distributed to farmers as compensation, assuming farmers knew about the bond. Alternatively, the investor could have been required to supply farmers with cash credit.

Conclusions

- DAFO takes significant risks with its reputation and relationships with farmers when it introduces investors and encourages farmers to enter production agreements
- If DAFO has a poor reputation among farmers or investors it is likely to be tolerated rather than welcomed
- Picking investors is risky because it is impossible to be sure of their quality or intentions
- Laotian production will only be competitive and compelling for investors if the variety is uncommon in China and the quality is high

Failure factors

1. Picking and promoting an investor
2. Inability to compensate or help farmers

Questions

- a. Why didn't the investor return after supplying the tea saplings and other support?
- b. Why would DAFO introduce an investor offering a weak proposition?
- c. Why does DAFO seem willing to be associated with investors proposing bad deals?
- d. Why would farmers know if an investor had deposited a performance bond?

9. Success factors

9.1. Internal factors

Internal factors can be specified and imposed through rules, regulations, or norms and manifest in a tangible and relatively predictable way. They are brought into being with the obligations, duties and terms of the production agreement. They are dependent upon the arrangement of a production agreement.

Written agreements – cases 1, 3, 4, 5, 6, 7, 9

Recording terms and conditions of a bargain between farmers and investors in writing improves understanding of what is expected of both parties and provides a reference point in case of dispute. Written agreements are a mechanism for transparency, certainty and confidence.

Market price – cases 4, 11

A free price follows a benchmark market price recognized by farmers and investors. Market price defends the integrity of the agreement because in theory the market price should always be the best price such that a trader would have to incur a loss to make a better offer. However, where a trader represents a distant market with greater purchasing power and less sensitivity to price then a better offer could be made to beat the local market price without incurring a loss. As markets become less fragmented because of improving communications creating more contacts and networks through which information can flow between investors, traders and farmers prices may become more coherent over wider territories. Market price agreements are often augmented to include a floor price to reduce the exposure of farmers to losses. Determining a floor price which reflects the interests and risks of farmers and investors may be a source of contention. Fixed prices are harder to defend as market prices increase. The endurance of a fixed price is partly determined by the strength of available means of enforcement.

Advance payments

Partial payment in advance demonstrates an investor has capital, commitment and confidence in the farmers and the production opportunity. A process to require advance payment may deter weak or insincere investors. If the investor

withdraws the advance payment functions as compensation for the farmers. Accepting advance payment may generate a sense of obligation among farmers. It may also create a barrier to obstruct entry of competing investors. Depending on the form of advance payment it may be recoverable if farmers fail to perform. Payments made before the crop is harvested take several forms. Inputs supplied on credit are not considered an advance payment because they are not cash, or in general not readily liquidated for cash, unless of course the crop is good and a new eager buyer appears.

Land-use fees – cases 6, 9

Investor pays farmers a land-use fee, based on area, before harvest. The sums may be relatively small. Recovering the money if farmers do not perform may be difficult because the money is given not lent unless there is a specific clause in the agreement. This practise appears to originate in China.

Universal interest-free credit – cases 4, 11

Investor lends credit to farmers without interest as a fraction of the estimated value of the harvest. If the investor withdraws the farmers should be able to keep the credit. If farmers fail to deliver for reasons other than adverse natural circumstances then the investor may have a reasonable chance of enforcing repayment because credit is a debt obligation. To function as an advance payment with the characteristics described credit has to be available to and taken up by a majority of farmers, in other words as good as universal. Where interest-free credit is available to a select minority of farmers for specific reasons it lacks the character of general advance payment.

Bonded investment – cases 6, 10

A bond worth 10 percent of the value of the estimated crop yield is lodged by the investor with DAFO. If the investor withdraws the bond is distributed among farmers as compensation. To be fair and effective requires transparency. Farmers must be aware of the bond. The mechanism for distributing the bond, for example division by land area, must be agreed during negotiations for the agreement. The bond is repayable immediately if

investors fail to perform. However, there is a possible down-side to this arrangement: funds deposited with authorities may be perceived by investors as a cost of business, thus increasing their overall costs, further reducing the opportunities for farmers to secure higher prices.

Certified production systems – case 1

Third-party inspectors certify a production system, such as Fair Trade or organic, to assure buyers of specific conditions. The production system adds value for which some buyers will pay a higher price. Higher prices can provide higher incomes which is an incentive for farmers to perform according to the production agreement.

9.2. External factors

External factors are aspects of the social or economic context within which the production agreement takes place. They may exist before and independent of the production agreement or may be cultivated as part of a strategy for building a receptive environment for commercial production. They reflect values, cultures, world views, behaviours and experiences. They are external to the production agreement but can exert influence on its performance and shape its relationship to the context.

Valuing relationships – cases 1, 2, 3, 5, 10

Investors who value relationships with farmers enough to invest time in developing the relationship are building a foundation of understanding, trust and goodwill with farmers. Equally, for a production relationship to weather misunderstandings and unexpected problems, farmers too have to commit time to listening, discussing and learning with, from and about the investor. The investor however has to make a greater commitment to building the relationship in order to build confidence for farmers to commit their land and labour in return for income some months later.

Social interests and reputation – cases 4, 7, 10

Farmers and investors who know each other, either through family or through the ties of community or society, can share interests and value their reputation because it is an indicator of risk and shapes how people will deal with them. They therefore can have a greater incentive to deal fairly and perform as agreed because if they do not the consequences can be

social as well as financial. In such situations the parties may work harder to solve problems. Furthermore, such ties can overcome obstacles posed by borders, creating the social foundations for more natural local economies.

Facilitators – cases 1, 7, 8, 10

Gaps between farmers and investors can be overcome by third-parties who have the information, awareness or language to bridge the gap. People or organizations who facilitate arrangements for production agreements may seek a social return on their investment, as with coffee in the south (case 1), or financial returns as in several cases in the north such as where Leu compradors from China are able to match Han investment with the land and labour of Leu in Laos.

Highly complementary production and consumption – case 1, 7, 10

Climatic and environmental difference between farmers and consumers creates potential for a strong opportunity. In such situations farmers have a greater comparative advantage and consumers have a greater need, subject to the limits of their purchasing power, because at least some of the time what they desire cannot be produced locally. However, connecting investors, who represent the desires of consumers, with farmers may require facilitators to overcome ignorance, information asymmetry, distance or language.

Market information – cases 1, 5, 7, 9, 10

Access to information on prices and other information about demand and opportunity at a regional scale help farmers judge whether offers made by investors are reasonable and also to negotiate better offers. Where farmers are dealing with investors from distant markets they may benefit from information about prices paid in those places by consumers. Timely and accurate market information reduces the power asymmetry between farmers and investors.

Balancing traders and investors – cases 1, 11

Farmers divide their crops between investors and traders. This helps maintain competition and limit opportunities for monopsony or oligopsony. Selling crops to investors and traders is also a form of insurance because more buyers reduce dependency and exposure to risks

should a buyer fail. Farmers balance by either splitting their fields between agreement and open-market production or by surreptitiously selling some of the crop grown under agreement to open-market traders.

Production agreements recognized as a device for realizing opportunity – cases 9, 10

Farmers and investors identify a production agreement as an arrangement which improves the conditions for them to realize an opportunity, such as assuring performance or obtaining some assistance from government offices.

Investors prize quality over price – case 1

When quality is the primary concern of investors they may be able and willing to pay prices higher than the market, if farmers can consistently deliver the specified quality. Investors will have to extend knowledge and technology in some cases. Paying contingent higher prices gives farmers a greater incentive to perform according to the production agreement and focus their efforts on the investor, even if the investor is a monopsony.

Selective participation – case 2

An investor, possibly assisted by local authorities or compradors and representatives, selects farmers to participate in production agreements by screening applicants by performance reputation.

Investor is reliable supplier of inputs and purchasing – cases 3, 4

Supplying inputs and other production support and collecting and purchasing crops according to dates specified in a production agreement builds confidence and supports development of a relationship with farmers.

DAFO supplies local production information – case 6

DAFO can supply information on the quality of local land and its suitability for particular crops so investors can develop realistic assessment of the production potential. Information has to be accurate, detailed and current for DAFO to provide a useful service to the investor and maintain or enhance its reputation.

DAFO facilitates negotiations between investor and farmers – case 6

Occasionally, DAFO can facilitate negotiations between an investor and farmers, particularly where the investor may not have social ties to the community of farmers.

9.3. Enforcement

Means

The most common means of enforcement is economic. The bargain between farmers and investors is satisfactory, providing a good reason for each side to perform according to the production agreement and invest time and effort to resolve any problems.

Social means are common too. Social relationships, family or friends, provided confidence and a positive environment for the formation of the production agreement between farmers and investors (cases 4, 7 and 10). Reputation and its risks are another element of social enforcement (case 4). Where social means are inadequate, for example a prospective investor is unknown and therefore had no reputation, farmers place DAFO between themselves and investors (case 9).

Administrative enforcement is present in several production agreements in two ways. One, recorded and tangible, such as an investor lodging a performance bond with DAFO (cases 6 and 10). Two, expected and intangible, such as resorting to DAFO for mediation and resolution (cases 8 and 12).

Legal enforcement was not indicated by farmers or investors in any of the cases.

Efficacy

A thorough assessment of the efficacy of each mode of enforcement is beyond the scope of this study. Nevertheless, a brief consideration suggests what may be more effective and appropriate given the circumstances. Economic and social enforcement appear to be the simplest and possibly the most effective. Parties which know each other and value their reputation in a community or society may be predisposed to negotiating a bargain which both recognize is in their own interests and the interest of the other party. Evidently, each side has to have an expectation of a reasonable economic gain to commit to perform according to the

production agreement and seeking to resolve problems amicably if problems arise. Amicable problem resolution would seem to be beneficial for reputations and relationships with society.

Administrative and legal means are mechanistic. Weaknesses in process and immaturity of structure and capacity leave processes vulnerable to error, incompetence and bias, whether in misguided pursuit of satisfying policy goals or corruption. Issues of accessibility aside, at the very least parties seeking resolution or redress through administrative or legal means expect systematic and balanced review of the dispute. If it is perceived as arbitrary and partial or unfair then the negative consequences for cooperation may last considerably longer than the immediate impacts of the dispute. As such their use or value in the maintenance of production agreements may best be limited to simple measures, such as receiving bonds for investment, until such time as capacities are developed to provide complex services effectively.



Foreign company promoting coffee production under agreement in Phongsali Province

10. Analysis and Discussions

10.1. Assets

Financial capital and credit – cases 1, 4, 11

Farmers often have insufficient capital to invest in their own production. They typically lack access to commercial credit on reasonable terms. Commercial banks are absent from many villages. Community-finance mechanisms, such as micro-finance, revolving loan funds, credit unions, and savings cooperatives, do not exist, are underdeveloped, or inaccessible in many communities. Consequently, farmers commonly turn to traders for credit, which is secured against either the coming harvest or their land rights. Repayment appears to be enforced by the threat of losing access to the only channel of credit available, and perhaps also administrative, legal and forceful means to seize land. It is also common for investors to advance credit, either cash or inputs, secured against crops expected in the current season, or in the case of a poor harvest the subsequent season.

Farmers frequently cite lack of capital as the obstacle to investing in their own production for sale on the open market. This indicates that there is demand for credit. Currently, credit is often supplied through relationships with traders or production agreements with investors. The entry of an alternative source of credit may disrupt those relationships. This may be beneficial if current arrangements are supplying credit at high cost. However, credit supplied through production agreements is typically, but not always, interest-free and therefore highly competitive and both a valuable service and powerful incentive for farmers. Conversely credit supplied by traders may be charged, although not necessarily at a level farmers consider unfair, through interest or discounted crop prices. Current credit arrangements may serve to support the position of several buyers who provide competition, assuming they are not an oligopsony, to support prices and better terms. Furthermore, interest-free credit supplied to most farmers under a production agreement functions as an advance and insurance against investor default.

Therefore it does not necessarily follow that the supply of credit by investors, and possibly even traders, is always and everywhere negative.

Availability of capital and credit has implications for the agency, choices and opportunities for farmers. It also has implications for their independence and security of their land. Capital and credit issues facing farmers are complex in ways which may not be readily apparent nor amenable to simple resolution.

Where credit is universally supplied, as discussed with regard to success factors internal to a production agreement (section 9.1), then it takes on characteristics of an advance payment. Investors therefore may have a greater interest in fulfilling the agreement. In a similar vein if investors are widely connected to farmers through extension of credit, either as inputs or selective credit advances, then they are to some degree sharing farmer risks and have more reason to continue supporting successful production in order to ensure farmer repayment of credit.

Advancing credit can also put investors and traders in advantageous positions should they have a strategy of land acquisition because where farmers struggle to repay in cash transferring land may be a viable alternative. Shi (2008) recorded analogous situations with regard to rubber in Luang Nam Tha, for instance.

Control and value of land – cases 2, 6

The terms and conditions of a production agreement or the value of production bond suggest there are investors in some circumstances who place significantly greater value on the land which the farmer supplies rather than the labour. This may indicate all other things being equal the investor would prefer direct access to the land and to dispense with the farmer. However, because the land is not readily available the investor's second, or sub-optimal, option is temporary indirect access to the land through the farmer via a production agreement.

Beneath this may lie an intention or aim to eventually secure direct control of the land, possibly by seeking to foreclose on debts the farmer may owe for inputs or alternatively arguing for a land concession. In some situations therefore

it may not be possible to discount the possibility that investors are motivated to engage in contracts as an interim step to acquiring direct control of land. It is unclear whether current arrangements for production agreements and associated policies and regulations are sufficient to ensure land rights belonging to farmers are not put at undue risk.

Information – cases 5, 6, 7, 9

Relevant and credible market information is not always readily available. In particular farmers need to know prices in markets which set regional prices. They also need to know trends in demand to inform their decisions on what to plant and with whom under what terms for a production agreement. Much of the market information farmers need has to come from neighbouring countries, and even beyond. Access to information is obstructed by several factors including technology, language and ignorance. When farmers face adverse information asymmetries they are at greater risk of entering unfavourable production agreements and failing to capture higher returns which instead may accrue to middlemen who enjoy a favourable information asymmetry. As discussed in the 'trends' section, market forces are already reducing this asymmetry and thus there is no clear need for government intervention, other than to remove obstacles to private, competitive information markets.

10.2. Structure

Market prices – cases 4, 11

Farmers who have market-price contracts nevertheless express a preference for investing in their own production for sale on the open market. This is a riddle. Market price was thought to be the answer to the problem of farmers breaking fixed-price production agreements for better spot market prices offered by traders.

The dissatisfaction can be explained by multiple market prices in some places. An investor offers a market price without always specifying which market is the benchmark. Problems may still arise even when investors and farmers agree on a benchmark. For example, a market may be specified in Thailand which farmers know and can check independently. The investor's market price will be lower to reflect costs and secure a profit as payment for supplying services, including capital, to link the farmer with the market. Come

harvest several traders, from China for example, appear or as likely their compradors call farmers on their mobile phones to find out how much the farmers have and to offer their market spot price. They represent different markets with different value perspectives. They may offer better market prices for several reasons including greater competition, purchasing power, potential to add more value, local shortages, subsidies and so on.

In such an environment of trans-national competition between markets for farmers, increasingly well connected by roads, a market-price production agreement may only remain attractive when the price reflects the highest available price to farmers, not the price of the market which best suits an investor or which the investor represents. This shifts considerable risk on to an investor because the price in a competing market may be high enough to wipe out the investor's margin.

If this explanation is correct it may suggest there is not much future for production agreements for commodities like maize when farmers have accumulated sufficient capital to invest in their own production and are reliably connected to several markets by road and mobile phone. In such cases, production agreements will have served the purpose of starting a process, and have given way to successive, perhaps more efficient, forms for organizing production.

Improvement in transportation and telecommunications is eroding the isolation and independence of local markets. Fragmentation of markets is giving way to wider market cohesion spanning borders. Regional-scale markets are developing between farmers, investors and consumers because market information flow is improving due to mobile phones and the ability to bulk-up and deliver orders by fast, all-weather roads. In this shift from local to regional markets investors may be losing their power to select a preferential market benchmark which enables them to capture more value. Farmers ability to influence the selection of market benchmarks may conversely be rising.

Monopsony, cartels and competition – cases 4, 7

It is common for an investor to enter into a production agreement with a village, even if not all the farmers take part. Often such exclusive or monopoly agreements are approved or actively facilitated by local authorities. Competing investors may be blocked from competing for farmers. Where

there are several investors in one district they can function as an informal cartel. A monopsony may be beneficial if it enables an investor to achieve scale in production and trading and to pass along some of the benefits such as near-market prices for the supply of inputs. This may depend on a mix of economic and social enforcement of reasonable terms, and possibly administrative enforcement.

Furthermore, a monopsony or cartel arrangement may allow investors to accumulate resources to provide reliable inputs and purchasing, plus services, such as interest-free credit. However, where public-interest pressures and bargaining power of farmers are weak an investor may be able to impose poor terms upon farmers. Competition, where it exists, comes either from persistent efforts of other investors each season or traders. Protection of farmers from the costs of monopsony while maximizing benefits is a challenge which may require several complementary solutions, including better market information and splitting production between investors or an investor and several traders.

Breaking officially-granted monopsonies, on the other hand, will require regulation or oversight from higher levels. In some cases, there may be a close link between contract farming, overseen and even organized by government officials, and the monopsonies or otherwise constrained and controlled markets. This is likely a counter-productive arrangement, at least from the perspective of farmers, where choices are constrained, options for pursuing new relationships are foreshortened, and the farmer's return on production is minimized. There is, thus, often a trade-off between open markets and the often higher prices, and production agreements with associated monopsony prices.

Often, district or provincial officials use market favours or privileges as an inducement to private investor assistance for infrastructure development such as construction of rural roads even hospitals or schools. Only where the investments facilitated by production agreements can directly justify the costs imposed on farmers are such arrangements profitable for farmers. Where there may be general, public good obtained from such agreements, but not disproportionately for the farmers, these arrangements are essentially unfairly shifting public costs to a few commercial farmers. Thus seldom do such public investments justify granting of unfair market advantages, at least from the perspective of the producing farmer.

Facilitators – cases 1, 7, 10

Facilitators can play a critical role in realizing opportunities by bringing farmers and investors together in production agreements. If the facilitator's position proves unsustainable then the production relationship may be in jeopardy if it depends upon the facilitator for maintenance. If the production agreement is dependent upon the facilitator then the facilitator may be able to dictate terms to both parties. Facilitators may extort advantages similar to monopsony and monopoly, particularly where they enjoy a favourable information asymmetry over farmers and on the sell-side to consumers. Ensuring opportunities for multiple facilitators may ensure competitive pricing.

Power asymmetry – cases 3, 9, 10

Investors, and facilitators-because of government organized administrative or bureaucratic limitations or controls on market access, lack of competition, dependency, and information asymmetry can hold disproportionate power to shape the terms and conditions of a production agreement. In such circumstances investors can use the power asymmetry to impose or dictate terms to farmers, for example insisting on fixed prices when farmers would prefer a market price. Similarly, authorities (DAFO and other offices) can impose terms, controls or prices. Farmers are then in a weaker position lacking opportunities to improve the terms of the agreements. Gebert (2010) made similar observations in an extensive study of farmer-bargaining power, noting also that the settings in which agricultural bargains were negotiated were adverse to the position of farmers and favourable to rent-seeking by officials.

Dependency – cases 3, 9

Although farmers have capacity to act or realize the bargain is not perhaps in their interest they nevertheless are hesitant to use their capacity or act to improve the situation. Fear of perceived power and consequences of challenging that power such as retribution may be one factor which cautions their actions. Yet on the other hand even with officials present farmers invariably spoke with frankness and candour. An alternative interpretation is farmers' relationships with investors or DAFO have in some circumstances developed aspects of dependency and paternalism, because of habit, culture, administrative constraints, or insecurity. If there are aspects of dependency

in farmers' relationships with investors and DAFO it may also hint at farmer reluctance to accept responsibility for their situation and actions. In any case, where farmers are short of confidence to use capabilities or act to find better opportunities they are imposing a limit on their prospects and perpetuating sub-optimal production agreements.

10.3. Misalignment

Sustainability of production – case 5

Production agreements have the capacity to increase and intensify production beyond the sustainable boundaries of the land. In such cases, the production agreement, production technologies, and regulations disregard ecological limits. The quality of biodiversity and the health ecosystems, preconditions to maintaining productivity, is degraded which in the short-term at least may be compensated by increasing dependence on inputs derived from hydrocarbons (Hooper, et al. 2005). Degradation affects resilience which can increase vulnerability to regime shifts (Scheffer, et al. 2001). Reducing hydrocarbon risk exposure and vulnerability to regime shifts requires maintenance of biodiversity and ecosystems at landscape scales (Swift, Izac and van Noordwijk 2004). Hence, it is not only important for the livelihoods of local farmers to maintain the quality of biodiversity and ecosystems but also for wider communities.

The production agreement is a mechanism for short-term capital accumulation between the investor and farmer often coming with long-term erosion of the ecological foundation of the livelihood and potential prospects of the farmer. Although land is not always an open-access resource, resolution of the problems of unsustainable cultivation facilitated by the capital-mobilization of production agreements may nevertheless require the production community of farmers and investors to act collectively. Markets have in general, especially where regulation is weak and quality poor, failed to internalize long-term challenges relating to sustainable resource use. Thus a clear need presents for coordinating mechanisms to conform production agreements to ecologically sustainable production limits.

Open-market aspirations – cases 4, 5

Farmers frequently expressed aspirations to switch from production agreements to open-market production. The obstacles to this switch are insufficient capital, market access, technology, and perhaps confidence. Production agreements are a mechanism for overcoming those obstacles. Where production agreements allow farmers to accumulate capital to then switch to open-market production the end of production agreements is clearly a success in enabling farmers to enhance their agency to pursue their goals. The goal of some, perhaps many, farmers is investing in their own production for open-market trading.

Government policy and activities emphasizes promotion and development of production agreements as the future of agriculture in Laos. In this respect, government policy and farmer goals are misaligned, the government is travelling towards more production and some farmers are travelling towards independent open-market production. Production agreements are useful and are unlikely to disappear. Nevertheless, the misalignment between government policy and farmers' goals may be reason to reconsider the weight of emphasis and resources deployed to promote production agreements, versus other opportunities for strengthening smallholder agriculture to expand prosperity, such as development of skills, technological knowledge and access to market information.



Spraying chemicals in maize field

11. DAFO – challenges and opportunities

11.1. Assessment of current DAFO situation

Agreement farming is changing the face of commercial agriculture all over Laos as evidenced in these cases studies. Equally evident is the remarkable lack of consistent, coordinated facilitation and regulation that shape the sharing of benefit and the burden of risk among the investors and producers. DAFO does not have a clear mandate to take charge of developing commercial farming generally nor oversee production agreements; but then neither does any other ministry: the ministries of planning and investment, industry and commerce, and agriculture and forestry share responsibilities for various aspects, and the district and provincial governors' offices take responsibility for larger investments. This lack of clarity plays out in different ways in different districts, largely driven by personalities and leadership capabilities. Where DAFO has strong leadership with experience or skills in facilitation, it is playing a central role in production agreements; where it is less capable, DAFO may simply play the role of field agent or even be absent from the equation all together.

If DAFO does engage in facilitating production agreements, there remain many hurdles. Foremost among these are lack of any standard methodology, tools, or rules to follow. Lao has in place no detailed guidelines or tools on which local facilitators could rely. No established norms lead common practice to more accountability and service to farmers.

Even when DAFO does take initiative to be proactive and work to improve agreement farming few have experience in facilitating large commercial deals, none have the training to adequately consider risks and opportunities for farmers. Furthermore, no DAFO have the standing to enforce agreements with multi-national entities. The services DAFO has experience with oversight of production technologies, provision of technical answers to production problems, and facilitating access to inputs such as seed and fertilizer are either irrelevant in commercial production agreements or obviated by the strengths and resources brought in by the investors.

Even were the mandate and the tools are in place, DAFO's do not have a budget adequate to fund substantial field activities required

to monitor and follow-up activities under agreements. This leads some DAFO to strategically focus on facilitating investors who can bring their own resources to deliver extension services, or to work with investors willing to put substantial funds into DAFO operations. Either way, the objectivity and independence of DAFO may be compromised.

With such resources as it can mobilize and capacities it commands, DAFO is expected to be the main actor in extending agriculture development benefits to farming communities throughout the country. Thus it is no surprise that in some districts, the DAFO administrators seize on production agreements as a tool to bring farmers into modern production, hoping this also brings them improved food security. With little experience working with and negotiating with companies, with little oversight, and with few of their own resources, DAFO are not in a position to adequately represent interests of farmers, and it is not uncommon for DAFO to fail to maintain objectivity or to put interests of (sometimes foreign) investors over the interests of farmers. Rent-seeking is not a surprising outcome (Gebert 2010), and is not confined to DAFO (case 8).

The extent to which DAFO fails to pursue the best interests of farmers is due to a misalignment of roles and responsibilities with capacities and resources. Yet farmers, planners, government leaders, and even companies continue to push for DAFO involvement. There may be opportunities to build on DAFO strengths and offset weaknesses, but it will be necessary to address the misalignment with aggressive and prompt measures. Failure to do so will be to allow further degrading of representation of farmer interests and up-scale a dis-service to farmers; if nothing is done to redress the lack of capacity, oversight, and standards, small-scale farmer sustainability and livelihoods will be undermined rather than enhanced. To turn the prospects of commercial farming from a threat to small farmers into an opportunity for expanded livelihoods requires a major overhaul of services facilitating farmer-investor relationships.

The expectations the private and public sector development partners place on DAFO may not be entirely misplaced. Despite all its flaws and

institutional shortcomings, DAFO may be in the best position at least in the short term and if capacity building efforts support it to promote efficient, fair transactions. Thus we are brought back to our original question number two: what can DAFO do to foster equitable arrangements and develop the context to encourage good performance by all parties?

11.2. Recommended improvements in extension support to production agreement

Reform is necessary for agricultural extension to remain relevant and effective for supporting sustainable livelihoods of smallholder farmers engaging in commercial production agreements. Reform by the Ministry of Agriculture and Forestry (MAF), NAFES and DAFO may inter alia embrace several elements

Recognize and build on various DAFO strengths

1. DAFOs typically have a fairly large staff both fully paid and part-time 'volunteers' waiting for quota positions larger than other local development-related offices
2. Many DAFO officers are accustomed and expect to regularly visit villages and work with farmers; and some have solid understanding of participatory analysis and planning methodologies
3. Collectively, DAFO officers usually have a decent understanding of general technical production capacity of different agro-ecological zones within their districts though this is far short of scientific, spatially-mapped, carefully delineated production zones
4. DAFO officers have some familiarity working with the mix of ethnic groups represented in various farming communities in their districts.

Governance, facilitation and enforcement

If DAFO's number one role is to represent and protect the long-term viability of smallholder farmers, this needs to be clear and publicly stated. Monitoring and evaluation mechanism should be fit tightly into management practices of each DAFO, to keep all agents in line with ministry objectives and methodologies. Where DAFO misaligns with these accepted norms - imposing greater risk or otherwise unfavourable conditions on farmers - reprimands and corrective action needs to be quick and consistent. DAFO needs an effective oversight body to provide checks and balances to the pressures

they face from private sector actors, and this body needs to act decisively in cases of dis-service. Direct access to this body ought to allow farmers to express concerns, such as the National Assembly's current 'hot-line'.

The government and smallholder agriculture

Within DAFO a view persists, expressed at the Luang Prabang workshop in May 2011 that conceives government as a production coordinator even controller. This view is not universal and may be a legacy of approaches to organizing agricultural production which were employed before the introduction of the New Economic Mechanism in 1986. Whether or not such a view reflects official policy, it is impossible to implement effectively and efficiently because the sheer magnitude and complexity of transactions in the agriculture market place far exceed the management capacity of a state agency. These minutiae of economic activity are the natural provenance of private actors: farmers can best decide what to plant on their land, investors will best decide into which crops they will put their resources, and farmers and traders will best decide when, under which conditions, and in what form to finalize agreements. The resources of DAFO will be most productively spent not in controlling and determining the agreements but in introducing actors, informing farmers about critical issues about risk and benefits, and advising farmers and investors about fair and productive practices.

Agricultural ecological sustainability

As presented in the sustainability of production, production agreements do not automatically consider the long-term carrying capacity of the agro-ecological zones. It is therefore appropriate for government to create screening mechanisms for large investment proposals and develop information and decision-making aids designed to help farmers consider ecological impacts of commercial farming.

Guidelines and tools

These tools and guidelines should contain information and enable analysis for risk, cost, and benefit sharing for the various parties to production agreements, supporting more informed negotiation and decision-making leading to more robust and fair agreements. These tools can be regularly revised, augmented, or replaced, but should contain separate tools oriented to facilitators and farmers.

11.3. Roles and responsibilities for DAFO in facilitating production agreement

For DAFO to align resources with mandates, and to place itself appropriately within the varied service providers and agencies involved, it is necessary to clearly define the role MAF expects it to play in supporting development of smallholder commercial farming and agreement farming in particular.

To enable smallholder farmers to regularly reach fair production agreements deals will necessary involve making space for and enabling farmer organizations, community organizations and non profit organisation (NPA). At the same time, DAFO may remain relevant and productive in facilitating production agreements if it improves capacity, oversight, and management to carry out the following activities professionally:

- Providing only demand-based services
- Providing information to farmers and farmer organizations—about negotiating good agreements, choosing good investors, arbitration procedures or recourse for redressing grievances, international pricing information, histories and performance of prospective investors, opportunities to fill demand for various products
- Facilitating farmer organizations to better organize producers in production agreements arrangements
- Brokering honest and open negotiations where farmers are ensured opportunity for fully informed consent and the right not to participate
- Enabling farmer choice of investors, of production agreements, of products
- Attracting quality investors by supporting positive and fair business environment with standardized procedures and consistent regulations for investors
- Supporting farmer learning on ecologically-sustainable production technologies and environmental impact of proposed commercial farming technologies.

12. Recommendations

Recommendations - General

1. Improve the foundations and context of agribusiness for farmers and investors, which would help define roles and responsibilities for DAFO (and other authorities).
2. Measure performance and create accountability connect rewards for local officials with performance through transparent feedback mechanisms from farmers and investors to judge the support and services they receive and follow-up on problem cases with strong corrective measures
3. Clearly define jurisdictions of agencies (case 8) – currently several agencies have authority and responsibilities for various aspects of agribusiness, which is a waste of precious government resources and creates confusion for farmers and investors, which may be exploited by investors, and result in problems farmers and investors expect DAFO to solve
4. Quality business environment to attract quality investors (case 6) – higher quality investors favour clear, transparent rules and regulations, such as assurance bonds, implemented by agencies with clearly-defined responsibilities preferably delivered through same-day service at a one-stop shop
5. Pluralism Create space and opportunity for non-government service providers farmer organizations, community based organisation (CBO), non profit associations (NPA), micro and small enterprises, producer groups and others to organize, facilitate, and negotiate directly with investors on their own standing
6. Standardize regulations (case 10) – ensure regulations for agricultural business and trade are uniformly implemented in all districts and are guided by a principle of efficiency and convenience to foster production and trade by farmers or investors
7. Arbitration – establish and publicize a standard simple and transparent procedure within communities for resolving disputes between farmers and investors which are currently at risk of leaving a legacy of conflict which sours the business environment (Fullbrook 2007)
8. Sustainability (case 5) – capital mobilization by production agreements offers prospects of raising incomes and reducing poverty, however this can lead unsustainable use of natural resources. To guard against this

likelihood and ensure the viability of commercial farming precisely as the agriculture sector grows in economic value (Grantham 2011), the sector needs new regulatory and management systems with a focus on the sustainability of ecosystem services.

9. Spatial organization – restructure support services to agricultural around natural production areas instead of district political boundaries to cut costs and improve efficiency and effectiveness

Agricultural sustainability

1. Identify and understand the characteristics and thresholds of agroecological zones
2. Support agricultural communities' environmental management plans and practises to maintain ecological services (case 5)
3. Monitor ecological state of production areas
4. Research, develop and promote ecologically-sustainable and climate-resilient agricultural practises, which are safe for farmers (Fullbrook 2007, 20) drawing on established international expertise and experience, including agroecological principles, of other developing countries including Brazil, Cuba, Costa Rica, Mexico and Vietnam
5. Assist with disease monitoring and management and safe production practises (Fullbrook 2007, 19)

Enterprise environment

1. Provide detailed information on local agricultural conditions and crop suitability to farmers and investors (cases 5 and 6) (Fullbrook 2007, 37)
2. Require farmers and investors to use standard production agreements which are clear and equitable as a prerequisite to access government services and arbitration support
3. Manage universal assurance scheme requiring investors to deposit performance bonds (or other advanced payment by mutual agreement with farmers) as a prerequisite for investing in production with farmers (case 6)
4. Coordinate with business development service providers including social-enterprise (case 1) to facilitate demand-driven services for production agreements
5. Support transparent and equitable dispute arbitration in the community (case 8) (Fullbrook

2007, 19, 37)

6. Motivate field staff with incentive payments contingent upon positive feedback through service-satisfaction ratings by farmers and investors

agricultural communities thereby allowing local agencies to focus limited resources on performing the recommended roles and responsibilities

8. Support development of social-enterprise facilitators (case 1) to connect farmers with distant niche markets

Development partners

The government can direct development partners to use some of their resources and expertise for resolution of transient issues to focus on developing the capacity of agricultural agencies to facilitate equitable contracts and create an enabling environment to foster agriculture trading.

1. Pilot research of commercial production and sustainability and the development of community environmental management plans translating the findings and experiences into training programmes for farmers, investors and officials (case 5)
2. Agricultural sustainability training programmes for farmers, investors and officials
3. Research and development of sustainable agricultural practises, drawing on experiences in other developing countries, and training for farmers and officials to continue sustainable-production innovation
4. Develop and support farmer business schools to travel through agricultural communities to fill gaps in knowledge about agricultural business, markets, and prices so that farmers may make fewer mistakes, reject bad deals, and present fewer problems to DAFO or other government agencies (cases 3, 4, 5, 7, 9, 10, and 12)
5. Accelerate farmer access to agricultural information through information communication technologies to access prices and agricultural news to reduce information asymmetries which currently disadvantage farmers in bargaining with investors with negative consequences for efforts to reduce poverty (cases 4, 5, 7, 9, 10, and 12)
6. Promote producer owned organisations (commercial or social enterprises, cooperatives etc) to efficiently deliver agricultural market and production information empowering farmers to take pre-informed decisions and the right not to get engaged in an agreement if they don't agree.
7. Support development of farmer clubs for specific matters, such as organic herbicides and pesticides, integrated-pest management, polycropping, animal husbandry, processing, climate change, as devices to internalize extension capabilities and services within

13. Conclusions

Production agreements have enabled farmers and investors to realize opportunities for production with outcomes which are successful. Analysis of the 11 cases which exhibited elements of success and 1 unsuccessful case has found answers for questions which guided the inquiry.

1. Why are some contracts for production between farmers and investors successful?

A successful outcome for a production agreement depends upon a range of factors internal or external to the agreement. Internal factors are written production agreements, market price, advance payments and certified production systems. External factors include valuing relationships, social interests, facilitators, highly complementary production and consumption, and market information. Several success factors can be promoted by policy and programmes such as:

- Written production agreements
- Market price
- Advance payments
- Certified production systems
- Facilitation
- Market information.

Not all factors need to be present for a successful outcome. However, the prospects for success may rise as the number of internal and external factors increases.

2. What can DAFO do to foster equitable production agreements and develop the context to encourage good performance by all parties?

DAFO's capability to have a positive effect at scale is severely limited by the current mismatch between roles and responsibilities, capacity, budgets and staff. If followed, the recommendations made above (section 11) would combine to make a DAFO that is responsive to the interests and needs of smallholder farmers across the country. In so doing, DAFO would help to level the playing field and create not only a fair environment for farmers, but a tenable business environment where both parties to agreements producers and investors stand to sustainably benefit from commercial transactions.

In answering this question about DAFO, obvious implications for broader government agencies arise. However technically feasible this transformation and reinvigoration of smallholder farmer services may be, many of the problems and issues facing DAFO are symptomatic of generic issues impairing government performance, especially at local levels. Thus, prospects for reducing poverty, improving well-being and strengthening national resilience rely on the improvement of governance generally, to make government services responsive to the interests of the smallholder farmers. Thus services from DAFO will only really improve if the general governance environment also improves. If nothing else is done, leadership can at least clarify and delineate authorities, jurisdictions and responsibilities of various line ministries and make agencies and staff accountable to citizens.

Farmers face deficiencies or weaknesses in availability of capital and credit, land rights and information. The structure of investment and market opportunities leaves them vulnerable to unfavourable terms because of power asymmetries. There are several significant misalignments: One, the intensity of production under production agreements exceeds ecological sustainability; Two, many farmers aspire to investing in their own production for the open-market while the government emphasizes production agreements; Three, the maximum potential for government to facilitate increased agricultural output in Laos may lie with authorities supporting external investors, even though the consequences may be poor bargains for farmers. These issues and misalignments are critical not just to the viability and livelihoods of smallholder farmers, but to the viability of commercial farming itself in Laos. They can reduce productivity which could depress output sufficiently to make agreement farming, and commercial farming in general, impractical for investors.

Challenges Ahead

Given the above analysis, the changes and improvements necessary for local authorities to positively support agreement farming will not be easy nor automatic. It is precisely on these issues played out both in policy field and at the local implementation level that the international donor community must involve itself to facilitate and enable this process of change. The larger

donors such as the UN have the standing to help address the mixed mandates. The smaller donors certainly contribute to the understanding necessary to address these issues, but at the same time, help establish the path of possible reform at local levels. Working directly at the ground level to enact responsive service programs, can build not just case examples, but the foundation of practical experience necessary for larger uptake of policy improvements. If nothing is done, the current trajectory will likely leave local authorities more of an impediment to producing agreements that improve the viability, sustainability, and food-security of participating farmers. It is critical for the various actors at the national and international level to undertake the analysis of resources and expectations to begin the realignment process that may put effective oversight and facilitation support at the service of smallholder farmers.

14. Further research

- What heuristics do farmers use to assess and compare the opportunities and risks of open markets and production agreements?
- How can farmers' access and understanding of market information be improved?
- What obstacles do farmers face in finding more buyers and better prices and terms?
- How can farmers manage and maximize benefits of dividing assets and output between investors and traders?
- Why are forms of advanced payment, such as bonds, land fees and interest-free credit, not used more widely in production agreements and what are their implications?
- How can farmers exert influence to ensure What is a fair premium for local cartels/oligopsonies in return for providing stability, reliability and interest-free credit?
- Why are there only a few socially-motivated market facilitators and how can their services be developed and applied more widely?
- How can production agreements implement sustainable production and what principles and practises, such as agroecology, can be developed to match the environments of Laos?
- What controls, quotas or support by the Chinese government shape the interests and behaviour of entrepreneur investors from places in China far from Laos?
- What products can farmers in Laos competitively produce for urban markets in China?
- How does the investment regime which gives privileges to selected investors reduce poverty and benefit the livelihoods of farmers?

15. Appendix

Producer prices in Laos and consumer prices in Beijing

Price/kilogram (in Yuan = 1,250 kip)

Laos, farm gate		Beijing, retail		
Banana	0.25	Supermarket	Fresh market	
		11.2	7	imported
		9.6	5-6.2	domestic
Watermelon	1	7.2	5-6	
Pumpkin	0.5-1.3	10-11	6-7	
<i>data collected Laos April/May 2011</i>		<i>data collected Beijing May 2011</i>		

Units & exchange rates

Area

1 hectare = 10,000 square metres
 = 15 mu (Chinese)
 = 6.25 rai (Thai)

Currency

Laos kip	China yuan (RMB) = 10 jiao 1 jiao = 10 fen	Thailand baht = 100 satang	United States dollar = 100 cents
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Exchange rates

	dollar	kip	yuan	baht
US dollar	1	8100	6.5	30
Lao kip	0.00012	1	0.0008	0.00362
Chinese yuan	0.15396	1250	1	4.52868
Thai baht	0.03288	260	0.21330	1

indicative rates April-May 2011 by oanda.com

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