

Contract agriculture – the future of farming?

Background

Marketing systems for agricultural produce have traditionally been open and transparent, evolving from their village or town market antecedents to a variety of public auction systems that exist for different farm commodities. The nature of these marketing systems is a reflection of market structures which involve a large number of ‘weak’ sellers transferring ownership of produce to a small number of buyers.

The progressive industrialization of agriculture, however, has highlighted the shortcomings of such marketing systems, and led to recognition of the greater supply-chain efficiencies that are available through various forms of vertical market organisation.

In some farm commodity sectors – notably broiler chickens, eggs, dairy and fruit and vegetables, there has been increasing degrees of vertical organisation implemented through arrangements such as forward contracts, production contracts, or even vertical integration by corporations. In other commodity markets, vertical organisation has been slower to develop, although there are signs such systems are starting to evolve.

Internationally, the proportion of agricultural products that are supplied through vertically-organised marketing systems is reported to be increasing significantly. For example, recent US statistics show:

- contact production of pigs has increased from around 3% of all US production in 1970 to now exceed 70%,
- more than 50% of all US fruit and vegetable production is now contracted
- 30% of all US beef production is contracted
- more than 20% of all US corn and soybean production is contracted.¹

Overall, some 35% of US agricultural production is now contracted.

Statistics on trends in contract agriculture in Australia are not readily available, although it appears likely that the proportion of total production that is contracted is considerably less than in the US, although increasing.

¹ Martinez, S (2002) “Farm business practices coordinate production with consumer preferences” FoodReview, Spring 2002.

It should be noted that in discussing contract agriculture, there is a subtle difference between forward contracts entered into by farmers as a means of price risk management (for example wool, cotton, beef or grain forward price or futures contracts with a financial intermediary that have an option of physical delivery) and forward contracts under which physical delivery of the produce in question is a requirement of the contract. The focus of this research is on this latter form of contract.

The growth of vertically-organised or contract agriculture has implications for farmers in three broad areas. These are:

1. Competition and market transparency issues associated with marketing farm produce under contract arrangements
2. Potential implications for Government policies on agricultural research, development and extension funding
3. Future developments concerning product quality standards and accreditation systems.

Given that contract agriculture appears to be at an earlier stage of development in Australia than is the case in North America and perhaps Europe, close consideration of its potential implications is of considerable strategic importance. The research outlined here is designed as a scoping study to identify some of the potential future implications of contract agriculture for farmers.

Project Objective(s)

1. To review the development of vertically-organised or contract agriculture internationally, especially in relation to developments over the past decade and likely future developments.
2. To review and estimate the extent of vertically-organised or contract agriculture in Australia, and to estimate likely future trends for each of the major farm commodities.
3. To review and report on policy developments internationally in response to the growth of vertically-organised or contract agriculture under three broad categories:
 - a. Competition and/or Fair trading policy

- b. Agricultural Research, Development and Extension policy
 - c. Farm and/or product accreditation and quality assurance systems.
4. To identify relevant policy initiatives that may be desirable in Australia in response to the growth of contract agriculture.

Scope

The project will effectively be a desk-study of the likely development of contract agriculture in Australia, and appropriate policy responses that may be required. It will, however, require interviews and discussions to be held with various agribusiness organisations involved in post farm-gate segments of agriculture in Australia.

The project will also require an extensive search of available literature on this issue internationally, and may necessitate more direct contact with relevant international authorities.

For the purposes of the study, the definition of contract agriculture is intended to include a variety of different forms of vertical organisation. These include production and forward contracts, vertical integration, and licence agreements associated with proprietary plant or animal species. As noted previously, risk-management instruments such as futures contracts are considered to be in a somewhat different category.

In relation to the three categories of issues identified for which there may be implications, it is anticipated that the researcher will review and report on existing arrangements including current funding levels, and draw on international experience if necessary to develop likely future scenarios.

In developing future policy options, it is not anticipated that detailed costings would be prepared for these, although careful consideration of the implications of these policy options should be included in the project report.

Outputs

The researchers will be required to prepare a comprehensive report that addresses each of the four project objectives. The Australian Farm Institute anticipates making the final report of the project available widely, and therefore requires that it be written in a plain English, non-technical style.

The report will be required to be prepared in a format as specified by the Australian Farm Institute, and made available in both hardcopy and electronic formats.

The project report may subsequently be the subject of seminars or workshops conducted by the Australian Farm Institute, therefore researchers may be required to participate in such forums as part of the project outcomes. Tenderers should include the cost of participation in one such forum in their proposal.

Timing

It is anticipated that the project would commence in August 2004, and be completed over a period of not more than twenty weeks. Potential contractors may wish to specify a variation to that timeframe.

Project Management

The Australian Farm Institute will require the successful tenderer to establish a project management team consisting of Australian Farm Institute and contractor staff to manage the project, and to ensure project milestones are met and outputs are delivered.

The contractor will be required to nominate the specific staff who will be engaged on the project, and the extent of their involvement. Substitution or secondment of staff will not be permitted without written approval by Australian Farm Institute.

Costs included in tenders must be all-inclusive, and provide a fixed-price costing for the entire project. No variation of costs will occur in the absence of written approval by Australian Farm Institute. A schedule of required progress payments should be included in tender documents.

Fees/Payments

It is anticipated that the total budget for the project will be in the region of \$40,000, although additional funding may be available from co-funders. Potential contractors should identify a proposed budget, and if necessary segment that budget so that the project could, if necessary, be carried out in a number of stages.

Contract Agreement

The contractor will be required to enter into a legally-binding agreement with the Australian Farm Institute as part of the commissioning of the project.

Further Information

Questions or requests for further information should be directed to:

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