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“Development on the margin”

Do Smallholders Gain from Contract with an Oil Palm Company? Lessons Learned from Jambi, Indonesia

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Abstract

The rapid development of oil palm area in Indonesia particularly under contractual arrangement has led to concern over the impact on socioeconomic benefits of the surrounded communities. This paper aims to increase our understanding of the impact of specific contractual arrangements in the oil palm sector on smallholders well being. It also explores the equity effect of the contracts for different groups of smallholders. A propensity score matching and treatment effect model are employed to deal with selection problems and endogeneity that may arise in this study. Data were collected from 245 smallholders consisting of 126 contract and 119 non-contract smallholders in three villages in one district in the Province of Jambi. We find that contract participation is attributed significantly by the age of household head, settlement status, size of oil palm plot, oil palm age and oil palm age square. Our findings suggest although contract smallholders allocate a higher cost per hectare for input, a higher price and a higher yield more than compensate for this, resulting in higher net revenue per hectare. The results show that, in general contract farming has positive and significant impact on per capita income. It is estimated that participation is able to increase per capita income by at least 52%. However, by classifying samples into two groups on the basis of total asset further analysis shows that there is a different effect of participation for different groups. The effect of participation is positively significant for the group that owns total asset equal or more than Rp 375 million (around US \$ 41,000) but it is not significant for group that owns total asset below the threshold. This difference is critical for policy implication.

Keywords: Contract farming, oil palm, propensity score matching, treatment effect model