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Can Contract Farming Reduce Vulnerability to Poverty among Oil Palm Smallholders in Indonesia?

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Abstract

This paper uses an asset-based vulnerability approach to investigate the poverty risk of smallholder farmers in the oil palm industry in Indonesia. In particular the question is asked to what extent contractual arrangements between smallholders and large agro industry companies are an effective means to reducing vulnerability, i.e. the risk from falling into poverty. In order to better understand such vulnerability, four types of shocks experienced by oil palm smallholders namely price, production, health and demographic and other economic shocks were also analyzed. Data were randomly collected from 245 smallholders consisting of 126 contract and 119 non-contract smallholders in the province of Jambi, Indonesia. Results show that contract smallholders tend to be more dependent on oil palm. They reported price and production shocks more frequently while non-contract smallholder experienced health, demographic, and other economic shocks more extensive. Using a probit model we find that the negative impact of price shocks can be reduced by participation in the contract scheme; however this is not the case for production shocks. We find that contract smallholders are significantly less vulnerable, however not because of contract participation but mainly because of their better asset endowments. The results of vulnerability estimates suggest that about 40% of smallholders are expected to be non-poor but the occurrence of shocks can make them fall back into poverty. Hence our findings differ from past publications on oil palm households' well-being which only looked at static poverty and thus reported low poverty headcount ratios. Our results suggest that policy measures must focus on reducing vulnerability rather than *ex post* poverty. Consequently contact schemes need to be reviewed in order to be more effective for the poor and vulnerable.

Keywords: Contract farming, oil palm, smallholders, vulnerability to poverty