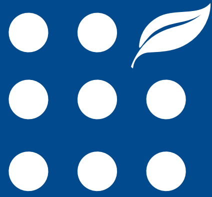
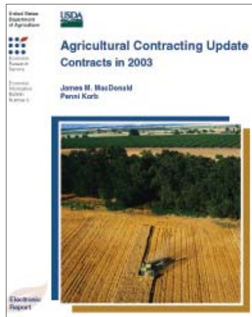


ERS Report Summary

Resources and Environment

Economic Research Service   January 2006   U.S. Department of Agriculture



This is a summary of an ERS report.

*Find the full report at **www.ers.usda.gov/publications/eib9***

Agricultural Contracting Update:

Contracts in 2003

James MacDonald and Penni Korb

Spot market exchanges in which commodities are bought and sold for immediate delivery continue to govern most transactions for U.S. agricultural products. But a growing share of farm product transactions are organized through agricultural contracts, agreements between farmers and their buyers that are reached prior to harvest (or before the completion of a production stage in the case of livestock) and which govern the terms under which products are transferred from the farm. Contracts provide for much closer linkages between farmers and specific buyers and may provide the contractor/buyer with greater control over agricultural production decisions.

What Is the Issue?

Increased reliance on contracting is one important feature of ongoing structural change in U.S. agriculture, and is closely tied to other features of structural change, including shifts of production to larger farms, increased specialization on farms, and greater product differentiation. Contracts can ease the production and marketing of more specialized product varieties, and can help create lower costs and increased efficiency throughout the food marketing system. They may also reduce risks for farmers and ease access to credit. But contracts reduce farmers' autonomy and they may harm the efficacy of some spot market institutions that are used for both spot market and contract transactions.

Contract usage features prominently in several policy issues, including the survival of family farms, the effects of processor concentration on farm financial performance, and the regulation of excess nutrients from large livestock operations. Information is limited on basic issues related to agricultural contracting, such as who uses contracts, how usage has changed over time, what prices are received under contract production, or how features of specific contracts have evolved. This bulletin provides timely information on these issues, drawing on a comprehensive survey of farm operators.

What Did the Study Find?

Contracts covered 39 percent of the value of U.S. agricultural production in 2003, up from 36 percent in 2001. Over the long term, contracting shows a strong upward trend--contracting covered 11 percent of the value of production in 1969 and 28 percent in 1991. While contracting appears to be growing steadily in the aggregate, growth varies within regions and among certain commodities. Recent increases in contracting are concentrated in hog, tobacco, cotton, and rice production.

Contracting is closely tied to farm size. Contracts covered just one-fifth of production among farms with less than $250,000 in sales, and over half (53 percent) of production on the largest farms, those with over $1 million in sales. Moreover, contracting increased among the largest

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farms between 2001 and 2003, but held steady or declined among smaller farms. Increases in contracting mirror increased volumes of production among large farms.

Our data distinguish between marketing contracts, which are used to set prices and determine market outlets for commodities produced under a farmer's direct control, and production contracts, which compensate farmers for the service of producing commodities for a contractor, with many inputs provided by the contractor. Mean prices received by farmers with marketing contracts for field crops matched average USDA marketing-year average prices for all soybean and wheat production, and exceeded the average marketing-year average prices for corn (3 percent), cotton (19 percent) and rice (62 percent). Some of the price advantage to contracts may reflect price premia paid for specialized varieties, and some may reflect timely marketing decisions. In cotton and rice production, the data show a shift toward greater reliance on marketing pools, in which the contractor assumes responsibility for marketing the crop committed by a pool of producers.

How Was the Study Conducted?

The study relies on data obtained from the 2003 Agricultural Resource and Management Survey (ARMS), USDA's primary source of information on the financial condition, production practices, resource use, and economic well-being of U.S. farm households. Some farms receive a core version of the survey, distributed by mail, while others complete longer versions through personal interviews with trained enumerators. Each version asks farmers about the use of production or marketing contracts and the volume of production, receipts, and unit prices or fees received for each commodity under contract. The longer version includes more detailed questions on contractors, contract terms, and alternatives available to farmers. The survey also includes questions about the farm business and the farm operator's household, which allows for a comparison of different types of farms.

This bulletin follows a more comprehensive ERS report that relied on data through 2001: Contracts, Markets, and Prices: Organizing the Production and Use of Agricultural Commodities (Agricultural Economic Report No. 837; November 2004). The current study updates the information in that report with 2003 ARMS data and also exploits survey questions to explore recent developments in contract terms.