

EMPOWERING FARMERS' ECONOMIC WELFARE THROUGH DEVELOPMENT OF OIL PALM INDUSTRY IN THE REGIONAL AUTONOMY ERA: LESSONS LEARNT FROM SIAK DISTRICT

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ABSTRAK

Pada tulisan ini diajukan alternatif kemitraan dalam bentuk contract farming untuk memadukan berbagai potensi yang dimiliki oleh pemerintah daerah, swasta, dan akademisi untuk meningkatkan kesejahteraan masyarakat. Model yang dikenal dengan ABG (Academician, Business, and Government) ini belajar dari kelemahan program kemitraan-kemitraan sebelumnya yang cenderung gagal atau tidak sustainable. Model alternatif ini dimungkinkan dengan meningkatkan kemampuan keuangan dan otoritas pemerintah daerah di era otonomi dan tersedianya lahan dan perusahaan swasta serta akademisi yang memiliki kompetensi untuk memanfaatkan potensi tersebut.

Kata kunci : Contract Farming, Pemerintah Daerah, Akademisi, Koperasi, Kabupaten Siak, Kelapa Sawit.

INTRODUCTION

Background and Problems

Laws Number 22/1999 regarding regional autonomy and 25/1999 regarding fiscal balance between regional and central governments, which then revised to become Laws Numbers 32/2004 and 33/2004 respectively, have provided more authorities for regional governments to govern their regions and to utilize resources available in the regions. Regional economic development can be conducted by regional governments in a more independent manner. It is expected that the enlarged authority of the regional governments is used to improve the economic welfare of the people. Such an improvement should be carried out in form of economic development programs employing natural resources sustainably, that can be enjoyed by as much people as possible.

Nowadays, critical problems found in every regions are poverty and unemployment. These are important indicators of economic development performance both for the central as well as the regional governments. Many policies intended to solve for these problems have been under taken, but most of them are not successful in significantly reducing the poverty incident and unemployment. The unseccessful policies include those which were formulated with less participation

of the people (or farmers if the area is of agricultural dominant) and with less consideration from other stakeholders.. Therefore, economic development programs in the regional autonomy era should be more inclusive in the social perspective.

In the past, development programs, originated from the state budget, regional government budget, or even from overseas loan, were generally conducted on the project basis. Farmers, as the target group, were treated as development object. Apart from being the receipient, their aspiration was not optimally sought. The project basis approach tended to be failure. Most of the development programs were unsuccessful in increasing farmers' economic welfare in a continuous or sustainable manner.

The failure took place because: 1) the development programs seemed to be project oriented, top-down, less integrated sectorally and spatially, and too small in the amount, 2) agricultural development programs were not well integrated in terms of vertical perspective (upper-to-lower activities) hence processing and marketing of the agricultural products were mostly uncertain, 3) farmers had relatively low self reliance in terms of income generation and hence the top-

down approach made them even more dependent on the assistance, and 4) apart of becoming members of the KUD (village unit cooperative), which generally is pseudo cooperative, farmers were not united in a collected effort with a legal binding such as "corporate farming".

In order to solve for or get rid of the problems above, and in line with the regional autonomy policy, the government of Kabupaten (District of) Siak has created and run a development program with the basis of the people economy ("ekonomi kerakyatan"). The concept of the people economy development approach fulfills a number of criteria including: 1) developing working ethos of the villagers and improving their skill so as to be able to utilise the surrounding potential optimally, 2) increasing job opportunity in the rural area, 3) having long run scope so as to be able to become a strong basis for future rural development, and 4) improving the access to appropriate rural or agricultural technology, credit market, and inputs as well as products markets so as to lead the farmers to form a resilience rural economy.

Considering the rural setting of Siak District, the regional government of Siak has chosen agriculture as the priority sector. The program of empowering the people economy is one of the strategic development programs in the district. An important implementation of the people economy empowerment is oil palm plantation development for the local people. The development of oil palm plantation is expected to be able to increase the income of the farmers, especially those living below the poverty line, as well as to create multiplier effects in other economic sectors of the district and hence accelerate the development of Siak District as a whole.

Objectives

Objectives of this paper are to: 1) briefly explain the oil palm development program for the rural people in Siak District, 2) highlight its implementation which involves participation of multi stakeholders including the farmers, the regional government, private sector, research institute and university, and 3) identify problems faced in the implementation and suggest actions needed to solve for the problems.

To reach these objectives, in Section 2, description of

Siak District will be presented. Section 3 will explain experience of PTPN V as a State-Owned-Enterprise in implementing oil palm development program for the rural people. Section 4 will be the conclusion, describing problems faced in the implementation, and suggesting actions or policies needed to solve for the problems.

GENERAL DESCRIPTION OF SIAK DISTRICT

Location and Potential

Siak District shares the location of the biggest Islamic Malay Kingdom called "Kerajaan Siak", which had had the golden era during the 16th to the 20th centuries. Heritages from the Kerajaan Siak, including the Palace of Sultan Siak, a number of mosques and cemeteries of the Sultans, still exist particularly in Siak Sri Inderapura, which was the capital of the Kingdom. Siak Sri Inderapura, now the capital of the District, is approximately only 100 km from Pekanbaru, the capital of Riau Province, or around three hours travel by road. It can also be reached through Siak River for approximately the same time duration.

Siak District is populated by approximately 300 thousand people, and covers the area of around 8556 km². The district is endowed with fertile soil, with ample of water from Siak River. Its topography is mostly of low land, some of which is affected by tidal waves. The higher parts of the area are only between 4 and 52 meters above sea level. This geographical condition makes the district suitable for agricultural activities, including a number of estate plantation crops.

Siak District is endowed with forest of around 483 million hectares. Out of this, 1.6 percent is protected forest, 14.4 percent is natural conservation forest (both of which, totalling 16 percent, may not be disturbed), 37.9 percent is production forest, 44.5 percent is limited production forest, and the rest is of other type of forest (industrial forest). There are a number of forestry industrial companies operating in the district, including PT. Indah Kiat Pulp & Paper, plywood industry of PT. Surya Dumai, PT. Siak Raya Timber, PT. Panca Eka, PT. Pertiwi, PT. Perawang Lumber Industry, and PT. Perawang Timber.

The share of agricultural sector, including forestry raw products, to the regional GDP is relatively high (around 32 percent). Manufacturing sector, mainly relates to agricultural and forestry outputs processing, contributes to the regional GDP by approximately 45 percent. About 42 percent of the workforce is indeed in the agricultural sector; 19 percent of the workforce is in the food crops sub-sector and 17 percent in the estate plantation sub-sector. Manufacturing sector absorbs around 17 percent of the employment.

Development Priorities of Regional Government of Siak District

Development priorities of the regional government of Siak District among others are on human resource, estate crop plantation (especially of oil palm for empowering the people economy), and infrastructure. With regard to human resource, there is around 30 percent of the population with primary school as their highest educational attainment. Relatively low education level and skill make a number of people trapped as being small scale farmers or unskilled labours. The poverty incident reaches approximately 9 percent of the population. The so-called poor and isolated villages are around 24 percent of the number of villages. Higher educational attainment and skill is necessary for structural transformation, which would enable the labour surplus in small scale farms move into the increasing manufacturing sector.

Empowering the people economy is another necessary step to develop a more prosperous Siak District. Estate crop plantations play significant role in this regard. Among the estate crop plantations, oil palm plantations are the most important one. Oil palm plantations in this District are run by private companies as well as by small holders. Oil palm plantation area in the region covers more than 125 thousand hectares, with CPO production of more than 420 thousand tons. The CPO production tends to increase. This increase would continue if the appropriate available areas are used for planting more oil palm in sustainable manner. The increased oil palm area and resulted CPO production would directly reduce the poverty problem if such increases are devoted to the people.

The incomes received by this people and the related industries would be higher if transportation and transaction costs are decreased. An important way of reducing these costs is to develop infrastructure, particularly roads and ports. Currently Siak District has three ports namely Pelabuhan Buat, Pelabuhan Perawang, dan Pelabuhan Siak Sri Inderapura, which have very limited capacity. The regional government of Siak is now preparing the development of Buton Industrial Area ("Kawasan Industri Buton", KIB) at Tanjung Buton, where a larger and more sophisticated port is going to construct.

Tanjung Buton is located in Kecamatan (Sub-district of) Sungai Apit, Siak District. This location is only around 112 km from the international marine line Malacca Strait, and the closest to the busiest area of Singaporean Philips Strait. In preparing the KIB, the government of Siak District has bought from the people an area of 5000 hectares in Tanjung Buton. The development of KIB is planned to have three stages. During the first stage (2003-2007), an area of 300 hectares will be ready for industrial purposes. In the second stage (2008-2017), industrial area will reach 1500 hectares with the availability of all infrastructures. During the third stage (2018-2027), the total area of 3500 hectares for industrial purposes will be occupied and fully operated.

In the first seven years of preparation and development of the KIB (2003-2010), the investment is estimated to be around Rp 4 trillions. This sum is for developing vital infrastructures including 380 km of roads, sewage and clean water treatment, electricity generators, business/economic facilities, and an international port with an area of 200 hectares. The government of Siak District opens possibilities to cooperate with private companies and/or other regional governments to develop the KIB, through among others "build-operate-transfer", "build-and-rent", "joint-venture", or other schemes. From the environment perspective, the KIB would significantly reduce pressures on Siak River which is getting busier with water transportations of people, logs and other raw products, and industrial products. This would significantly save bio-diversities in the river and surrounding mangrove forests.

Table 1. Areas of Plasma Plantations Managed by PTPN V in 2004

No	Commodities/Estate	Project Name	# Farmers (HH)	Area (Ha)
A	Oil Palm			
1	Sei Buatan	NES ADB	2500	5000
2	Sei Buatan	PIRSUS II	2250	4500
3	Lubuk Dalam	PIRSUS II	2750	5500
4	Bagan Sinembah	PIRSUS II	3000	5988
5	Bagan Batu	PIRLOK I	2354	4703
6	Sei Tapung	PIRSUS II	2500	5000
7	Sei Galuh	NES ADB	4000	8000
8	Sei Garo	NES ADB	2987	5974
9	Sei Intan	PIR Trans	3000	6000
10	Sei Pagar	PIR Trans	3000	6000
	Sub-Total			56665
B	Natural Rubber			
1	Binio / P. wangi	NES II IBRD	5231	7704
2	Bukit Selasih/D. Tiga	NES IBRD	3100	6157
3	Sei Siasam	PIRSUS II	2000	4000
	Sub-Total		38672	17861
	TOTAL			74526

Source: LM-PTPN V, 2004.

EXPERIENCE OF PTPN V IN DEVELOPING OIL PALM PLANTATIONS FOR THE RURAL PEOPLE

Plantation Areas Managed by PTPN V

PTPN V has managed plantations of oil palm as well as natural rubber as large as around 155 thousand hectares, consisting of approximately 80 thousand hectares of nucleus plantations and 75 thousand hectares of farmers (plasma) plantations in the Province of Riau. This is under the nucleus estate and smallholders scheme ("Perkebunan Inti Rakyat", PIR), as directed by the central government according to Minister of Agriculture Decree (Kepmentan) Number 819/Kpts/KB.510/11/96 regarding the management of PIR.

The plasma plantations originate from the NES-Asian Development Bank project of almost 19 thousand hectares, the project of Special PIR II of almost 25 thousand hectares, the project of Local PIR I of almost 5 thousand hectares, the project of transmigration PIR of 12 thousand hectares, and the project of NES-IBRD of almost 14 thousand hectares. These plasma plantations involve 28,341 households of oil palm farmers and 10,331 house-holds (HH) of natural rubber farmers. With regard to plasma oil palm

plantations, the area is almost 57 thousand hectares, which are around three times of that of natural rubber plantations. The detail is presented in Table 1.

Plasma Plantations Development of KKPA and "Partnership Plus".

Currently there is no more program credit (credits made available by the central government, such as the PIR projects) for developing plasma plantations. The interest of local people to have oil palm plantations, especially those who have not had one during the PIR scheme, on the other hand is so high. This is because farmers owning oil palm plantations have considerably higher income than farmers in the other group do. The latter do not participate in the scheme because they did not know the prospect of oil palm products. When it is apparent that oil palm plantations give good income, land availability is already scarce and there is no more relevant credit program. As a matter of fact, many villages which are of poverty packages in Riau Province had not been reached by the late PIR scheme. Unfortunately, most of land has already been 'owned' (its concession) by private companies, developing large scale plantations.

As a State Owned Company thus PTPN V cares and keeps its commitment to develop oil palm for the

local people who do not have their own plantations. Such a development has been carried out through two patterns, namely 1) KKPA scheme, and 2) “partnership plus” scheme in Siak District.

A. KKPA – PTPN V Scheme

This scheme is undertaken by utilising facility of “primary cooperative credit for their members” (Kredit Koperasi Primer untuk para Anggotanya, KKPA) to develop the plantations and provide extensions for the farmers. The facility is only used for local farmers having their own land but do not have sufficient fund, technical ability and knowledge to build their own plantations. The KKPA–PTPN V scheme is conducted in accordance to the Decree of Riau Governor Number 07/2001 regarding the Procedure to Develop Oil Palm Plantation through Utilisation of KKPA.

a. Development Stage of the KKPA – PTPNV Scheme

In so far, local farmers have proposed to develop new oil palm plantations under the KKPA – PTPN V scheme by as much as 80 thousand hectares. The realised area is only 4200 hectares. In the first stage of the scheme (by 2001), development of oil palm plantations for the people covered 1200 hectares, 1025 hectares of which are in Kampar District and 175 hectares in Indragiri Hulu District, involving 600 farmer households. Locations of the plantations are generally adjacent to PTPN V’s plantations, so that it will not take long time to bring the oil palm fruit to the processing units. In the second stage (by 2004), the development realised 3000 hectares of oil palm plantations, involving 1500 farmer households. These are located in Kampar District (2050 hectares), Rokan Hulu District (600 hectares), and Indragiri Hulu District (350 hectares). During 2005, it is estimated that the scheme has been realized for around 600 hectares of oil palm plantations in a location called AMO. It is estimated that during 2006, under this scheme, 3000 hectares of oil palm plantations will be established in Indragiri Hulu, Kampar, and Kuantan Singingi Districts, whereby the seeds have already been available. More details are presented in Table 2.

b. Sources of Financing of the KKPA – PTPN V Scheme

The source of financing for the first stage development was from Bank Agro, with a commercial interest rate of 19 percent per annum and 4 years grace period. The source of financing for the second stage development was from Bank Mandiri, also with a commercial interest rate.

c. Procedures for Proposing Oil Palm Plantation Development under the KKPA – PTPN V Scheme

- 1) Cooperative submits a proposal for developing oil palm plantation under the KKPA – PTPN V scheme
- 2) Selection of proposal by PTPN V, which includes documents on the cooperative legal aspect, annual member meeting of the cooperative, recommendation from the authority, governor’s letter on availability of the land, list of candidate farmers, location map, and analysis on the environmental impacts.
- 3) Upon the approval from the Board of Directors of PTPN V, permit is sought from the share holders at share holder general meeting (SHGM) (the proposal and FS are attached).
- 4) If approved, SHGM gives the plafond (ceiling), plantation budget and the bank which will finance its development.
- 5) PTPN V will appoint a research centre or consultant to undertake a feasibility study.
- 6) From the feasibility study results, PTPN V will decide which cooperative(s) is(are) going to be financed and write a letter to the bank which will finance the development.
- 7) Cooperative then accomplish documents needed by the bank (request of loan, reference of feasibility from PTPN V, MoU between the cooperative and PTPN V).
- 8) After the bank gives its approval, then a credit agreement between the bank and the cooperative is signed, witnessed by PTPN V.

Table 2. Realisations and Plans of Developing Oil Palm Plantations for the People under the KKPA – PTPN V Scheme

Plantation	Stage I	Stage II	-	Plan	Total
	2001	2004	2005	2006	
<i>Development of the KKPA Plantations</i>					
SPA	275	1900	0	1200	3375
SGH	100	150	0	0	250
SGO	50	0	0	0	50
STA	400	200	0	200	800
Dev't of STA	200	400	0	400	1000
AMO-1	50	150	0	0	200
AMO-II	125	200	0	0	325
Dev't of AMO			0	1200	1200
TOTAL	1200	3000	0	3000	7200

Source: LM-PTPN V, 2004.

9) PTPN V seeks for an approval for taking the investment credit under the KKPA scheme from Minister of State Own Enterprise through the Board of Commissioners.

10) When approved, PTPN V makes a schedule of taking and using the credit as well as repaying it.

d. Problems with the KKPA Scheme

The main problem faced by this scheme is the finance. Since there is no more program credit, it is very difficult to have the source of financing. Banks tend to be very reluctant to provide the needed credit due to the length of the investment period. It is perceived to be a very risky activity, particularly after a number of debtors fail to repay the credit. Currently, long term credit is generally limited to not more than 5 years. On the other hand, oil palm plantations would take 3 years to start yielding the output with still sub-optimal productivity level. In addition to this "mismatch", interest rate of the credit is high, i.e. 18 to 19 percent p.a. This high cost of capital causes the amount of repayment becomes considerably high and/or longer time to complete the repayment. This is the reason why the development of oil palm plantations under this scheme is so slow.

Another problem that makes such a slow development is of legal aspect of the land. Overlapping certificates sometimes occur on the proposed land.

B. The "Partnership Plus" Scheme in Siak District

The implementation of Law Number 22/1999 has provided wider autonomy and authority for local governments to utilise the available resources. The implementation of Law Number 25/1999 regarding the fiscal balance between central and local governments (i.e. fiscal decentralisation) enables the local governments to execute their functions. As a result, the planning and implementation of the development process have changed from centralistic and top-down to become more decentralised and bottom-up. This opens the possibilities for local governments to increase their role in fostering economic development, or at least directs them to put more consideration on the aspirations and welfare of the people.

Through the fiscal decentralisation, resource rich regions obtain more financial resources, among others through general allocation fund (DAU) and specific allocation fund (DAK). Siak District is one of the few regions that obtains significant amount of the funds. Its total budget exceeds Rp 1 trillion in recent years. The district government of Siak has a good will to utilise a portion of the budget to directly empower the local economy through development of oil palm plantations for the people. This particular portion of the district budget is the source of fund for developing oil palm plantations for the local people. The government of Siak District has prioritised the allocation of such

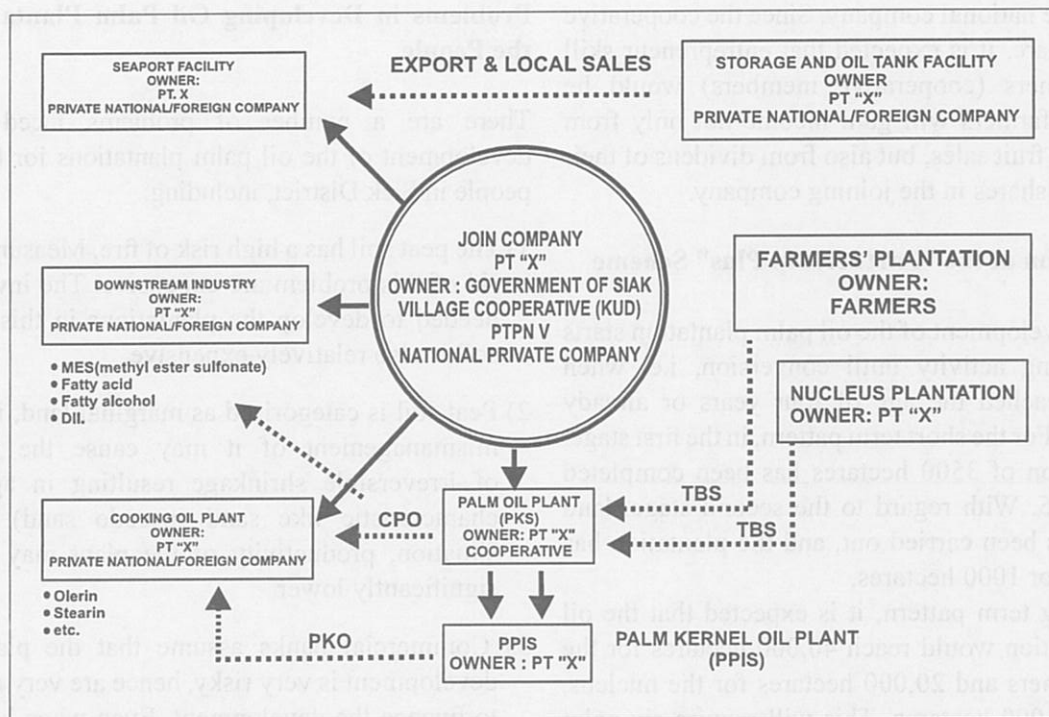


Figure 1. The Scope of Business in the Long Term Pattern of the Partnership Plus Scheme

plantations for farmer households living under the poverty line. The plantation development has been started since 2003.

a. Basis of the Development Implementation

The legal basis of this development is the MoU between District Government of Siak and PTPN V No. 6/2003 and No. 01/05.01/05.P2/IV/2003 on 10 April 2003, which were then followed up by common decisions of the District Head and Director of PTPN V No. 01/2003 and No. 01/05.01/05.P2/X/2003 on establishing a working team for preparing the plantation development. Both parties cooperate also with a commercial bank, PT. Bank Negara Indonesia, as marked with an MoU dated 10 April 2003.

b. Patterns of the Scheme

Patterns of the plantation development scheme are of short term and long term. The short term pattern is carried out as a crash program, in which PTPN V only acts as the plantation developer. The main objective is to reduce the poverty as quick as possible. Under this pattern of the scheme, plantation land is made

available by the government. PTPN V develops oil palm plantation on it. The areas are 3500 hectares for the first stage and 5182 hectares for the second stage. Once the plantation has been developed, it is then allocated to farmers, 3 hectares for each farmer household. The farmers work in groups, and the groups of farmers form a cooperative. Their plantations act as plasma plantation. PTPN V obtains an area for nucleus plantation.

Plasma plantation, nucleus plantation, District Government of Siak, and a Private National Company will form a join company. This is the long term pattern. Here the cooperation is expected to be not only on plantations (the third stage plantation development), but also an integrated down stream industries developments. These will be the responsibility of the join company. During the plantation and industries developments, local people will be recruited as workers. Thus in addition to having the plantation, they will also gain wages during the development processes. The design of the long term pattern of the partnership plus scheme is as follows.

It can be seen from Figure 1 that owners of the joining company ("Perusahaan Patungan") are District Government of Siak, the farmers' cooperative, PTPN V,

and a private national company. Since the cooperative owns the share, it is expected that entrepreneur skill of the farmers (cooperative members) would be better. The farmers will gain income not only from the oil palm fruit sales, but also from dividends of their cooperative shares in the joining company.

c. Realisation of the "Partnership Plus" Scheme

Physical development of the oil palm plantation starts from planting activity until conversion, i.e. when the plant reached the age of four years or already productive. For the short term pattern, in the first stage, the plantation of 3500 hectares has been completed in July 2005. With regard to the second stage, land clearing has been carried out, and the plantation has been done for 1000 hectares.

For the long term pattern, it is expected that the oil palm plantation would reach 40,000 hectares for the plasma farmers and 20,000 hectares for the nucleus, totalling 60,000 hectares. This will require six palm oil processing units with the capacity of 60 tons of oil-palm fruit per hour and a kernel oil processing unit of the same capacity. Out of the planned areas, so far 9,800 hectares of land have been surveyed.

d. Financing the Plantation Development

Until now, 100 percent of the financing originates from the government budget of Siak District. Most of the plantation area and the surrounding are of peat soil, in which the development cost is higher than that in mineral soil. On average, the investment needed for oil palm plantation in peat soil reaches Rp 28 million per hectare, whereas that in mineral soil Rp 22 million per hectare. In the peat soil, on average (per hectare), land clearing and plantation is Rp 10.8 million, treatments for year-1 plants Rp 5.7 million, treatments for year-2 plants Rp 5.8 million, and treatments for year-3 plants Rp 6.2 million.

CONCLUSION AND SUGGESTION

Before concluding this paper, it may be useful to list a number of problems faced in the implementation of the KKPA scheme as well as in the short term pattern of the partnership plus scheme.

Problems in Developing Oil Palm Plantation for the People

There are a number of problems faced in the development of the oil palm plantations for the local people in Siak District, including:

- 1) The peat soil has a high risk of fire. Measures to get rid of this problem are expensive. The investment needed to develop the plantations in this type of soil is also relatively expensive.
- 2) Peat soil is categorised as marginal land, in which mismanagement of it may cause the problem of irreversible shrinkage resulting in aggregate characteristic like sand (pseudo sand). In this situation, productivity of the plant may become significantly lower.
- 3) Commercial banks assume that the plantations development is very risky, hence are very reluctant to finance the development. Even when banks are willing to do so, there is a mismatch between the length of projects banks would like to finance and the lengths needed by the farmers.
- 4) Difficulties in finding a parcel of land which is sufficiently large. This is due to the past policy which gave utilisation rights ("Hak Guna Usaha", HGU) on large scale lands at relatively good locations to a few big companies.
- 5) Most of the lands mentioned in 4) are let barred. When this is the situation, by law actually the rights are automatically cancelled, and the lands are given back to the state. However, this is very difficult to realise.
- 6) Cost of capital or borrowing interest rate is relatively high. The high inflation rate (i.e. 17 percent in 2005), would tend to make the interest rate persistently high. Unless the interest rate could be lowered, it is quite difficult for the "partnership plus" scheme to attract a private national company participating in establishing the join company.

Solution: Contract Farming Model

Why Contract Farming: Meaning, Types, and Benefits of Contract Farming

The term “contract farming” in Indonesia is more widely known as partnership. It is said that the New Order regime at that time was quite dislike the term “contract” since it reminded people about “*koeli kontrak*” (contract workers) during the colonial era whose life during that time was very apprehensive. Until now, the term “partnership” is more popular in Indonesia. Contract farming system is one institutional mechanism (contract) which strengthens the bargaining position of farmers by linking them directly or indirectly to the corporation having relatively stronger economic level. Through the contract, the small scale farmers can be transformed from traditional/subsistent ventures to high-value and export oriented production entities. This is not only potential to increase the income of small scale farmers joining the contract, but also has multiple effects toward rural economy and broader scale economy (Patrick, *et al.*, 2004).

Contract farming can also be meant as the middle scale production and marketing system, where there is a division of risk responsibility for production and marketing between agribusiness actors and small scale farmers. All these are conducted with the purpose to reduce the transaction costs. According to Eaton and Shepherd (2001), contract farming can be divided into five models. *First*, centralized model, i.e. the model that is vertically coordinated, where the sponsor buys the product from the farmers and then processes or packs and markets the product. *Second*, nucleus estate model, i.e. the variation of centralized model, where in this model the sponsor of the project also owns and administers the estate land which is usually near the processing factory. *Third*, multipartite model, i.e. usually involving corporate body and private company who collectively participate with farmers. *Fourth*, informal model, i.e. the model that is usually applied to individual entrepreneur or small scale company which usually makes seasonal-based informal production contract that is easy for farmers. *Fifth*, intermediary model.

In Indonesia, commonly, we know four types of contract/partnership, i.e.: *First*, plasma nucleus partnership type, i.e. the partnership relation between partner group and partner company where the partner group acts as the nucleus plasma. The partner company builds the partner group in a) land provision and preparation, b) providing production means, c) giving technical guidance on business management and production, d) gaining, mastery, and improvement of technology, e) financing, f) other assistances like business efficiency and productivity. *Second*, sub-contract type, i.e. the partnership relation between partner group and partner company where the partner group produces components needed by the partner company as part of its production. *Third*, common trading type, i.e. the partnership relation between partner group and partner company, where the partner group supplies the needs of the partner company in accord with the requirements set. *Fourth*, operational collaborative system, i.e. the partner group provides capital and or means for venturing/cultivating.

From several types of contract farming explained above, it implies that the collaboration between farmers and second party can be well entangled if there is mutual interdependence. In other words, contract farming in agricultural sector can be profitable for both parties, i.e. farmers and company (sponsor). Contract farming enables broader support and can handle problems related to lack of information. Besides, contract farming also reduces the risk for farmers. The farmers get assurance that their product will be bought at the harvest time. In the long run, they also gain benefits, i.e. the partnership opportunity in the future and the access to the government programs. According to Key and Runsten (1999), the benefits of participating in the contract are market access development, credit and technology, better risk management, better employment opportunities for family members and indirectly, women empowerment as well as development of successful trading culture.

It is therefore clear that the “partnership plus” scheme is a type of contract farming, which is more complex in structure as it involves more participants. More detailed on the structure of this scheme is outlined below.

B. More Detailed Contract Farming Scheme: the "ABG" Model

a. The ABG Model in the Short Term

It was mentioned that the partnership plus scheme is a type of contract farming. It is clear that the simpler the environment faced by the farmers, the less complex the structure of the model is. With regard to the development of oil palm plantation for the people, the activities (from the planning until the implementation and evaluation stages) relate closely to a number of institutions with specific functions. This includes the farmers, the local government, private sectors (experienced developer of the plantation and a channeling bank), research institute and university, as depicted in the Figure 2.

As can be seen from Figure 2, the functions or responsibilities of each related institution are presented in the relevant box. The Academia (research institute and university) play important role in conducting the preparation survey and feasibility study. They are also involved in the preparation of human resources and monitor the plantations once established. Since PPKS produces the seeds, it also supplies the required

seeds. The private (Business) sectors involved are PTPN V and the bank. In this short term model, the bank function is only to channel the fund from the local government, whereas PTPN V plays pivotal roles in the model. It is PTPN V itself that guarantee the marketing of outputs produced by the farmers as well as the needed technology in the plantation. Endowed with significant amount of budget, the local Government of Siak in this model provides the required fund to prepare and develop the plantation. Its public service obligations, including providing the basic infrastructures and community development, would ensure that in the short term the poor farmer households would be made better off by allocating three hectares of oil palm plantation to each farmer. This approach is called the ABG-Model (abbreviation taking from the first letter of the three groups of institutions).

b. The ABG Model in the Long Term

Centre to the long term pattern/model in Figure 1 is "Perusahaan Patungan" or joining company. This company integrates or enjoins functions or interests of all institutions involved in the business. There are two reasons why the joining company is needed. *First*,

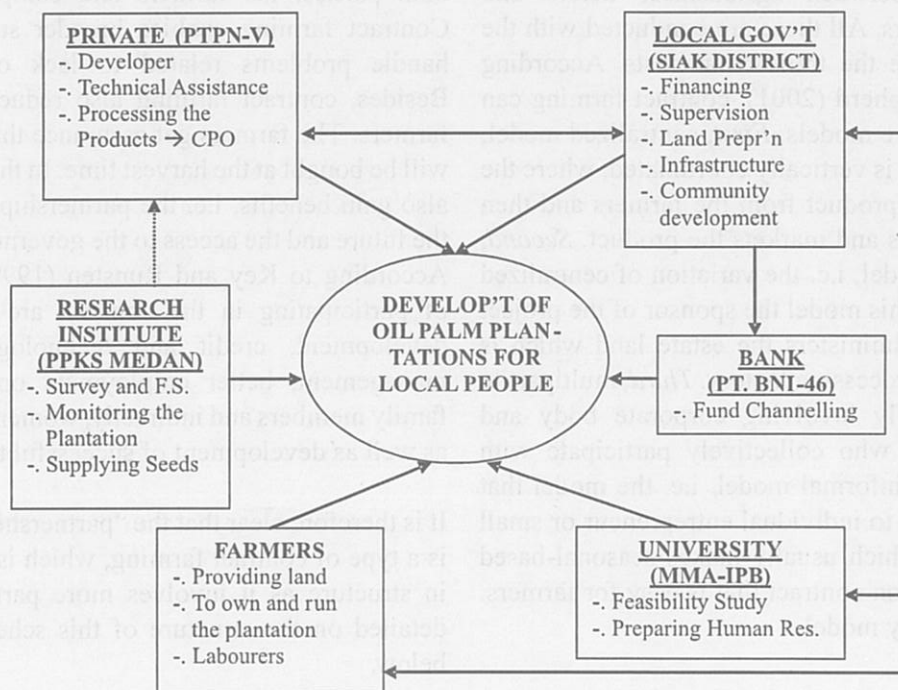


Figure 2. The ABG-Model in The Short Term

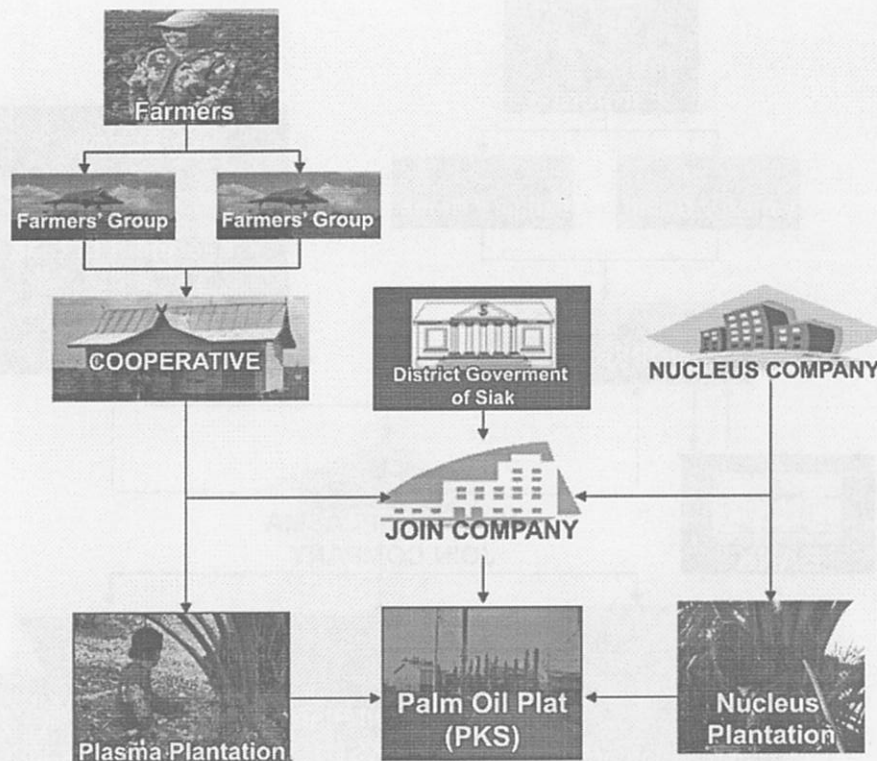


Figure 3. The ABG-Model in The Long Term – Variant 1

Vision and Mission of Siak District suggests that all economic or development agents should be growing in a fair and sustainable manner. Since different agents may have different interests, there is potential conflict of interests. Enjoining the parties in a company may reduce such a conflict.

Second, technically and financially oil palm plantations and processing units are feasible to be developed in Siak District. This development is badly needed by the farmer households living below the poverty line. This must be made in the short run or as quick as possible. But with only three hectares of oil palm plantation for each household, the sufficiency and sustainability of their income would remain uncertain unless they are involved in the processing units of plantations, which will of course provide more added values. Thus farmers as well as the other institutions should be bound together in a company, which is the joining company. This plan is in line with Local Government Decree (“Peraturan Daerah”) No. 7/2001 regarding District Own Enterprise called “Sarana Pembangunan Siak”.

The long term model could have many. The variants may rise mainly with regard to forms of ownership of

the joining company. At least there are two long term models can be proposed. *First*, the joining company owned by cooperative of farmers, nucleus company (PTPN V), and District Government of Siak. This is presented in Figure 3. A limitation of this model would be a constraint on the amount of funds available for developing the lower stream industries. In addition, apart from these three institutions the other institutions drawn in Figure 2 are absent in this model variant.

These limitations would perhaps be overcome at least partially if in addition to the three institutions depicted in Figure 3, “investors” are also included. This variant is presented in Figure 4. The investors could consist of the left over parties from Figure 2 plus national or even international business entities. This would overcome the constraint on finance. By overcoming such a constraint, a variety of down stream agro-based industries (not only CPO) can be developed.

In order for the proposed models to effectively work, there are a number of actions need be taken. They are as follows.

- 1) Problems regarding the availability of land for developing the plantations must be solved for. This needs involvement from the authorities in

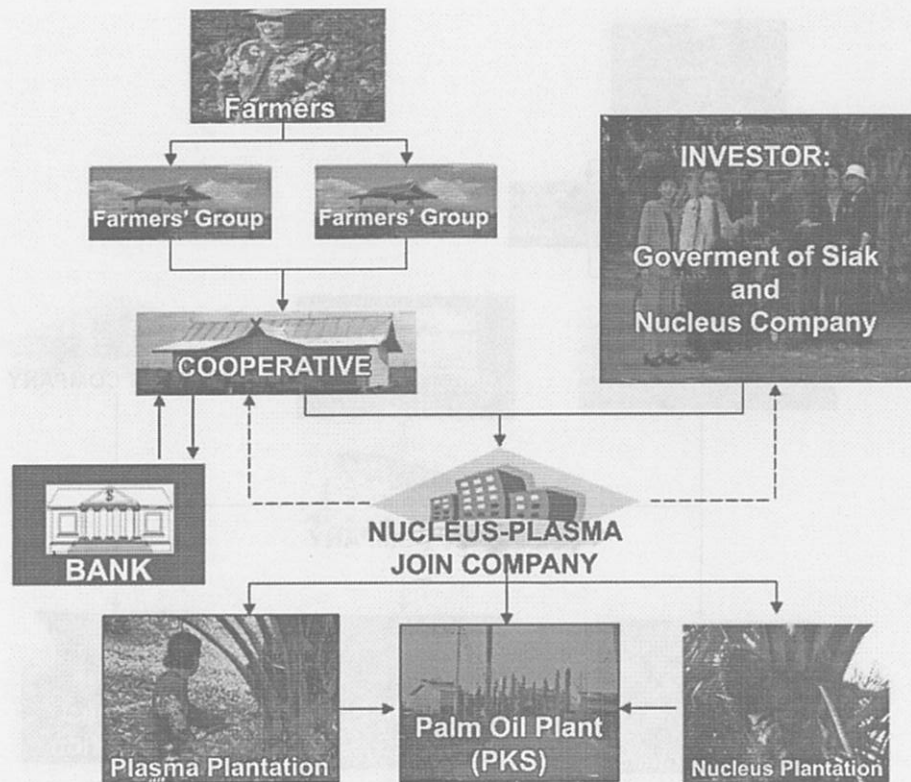


Figure 4. The ABG-Model in The Long Term – Variant 2

the central government, including Ministry of Forestry, Ministry of Agriculture, and National Land Agency. These institutions need to work synergistically to solve for the problem in Siak and other Districts of the country facing similar problem. For instance, the HGU lands that are left barred should be taken back by the government.

- 2) High costs of capital or borrowing interest rate have to be lowered. This needs a macroeconomic stability ensuring a steady decrease of the interest rate.
- 3) The mismatch between the willingness of commercial bank to finance plantation development upto a relatively short time and the actual time needed in developing the plantations need be bridged. The bridge may be provided by another bank (e.g. regional development bank) or investors with sufficient amount of funds.

- 4) Independent of stages of plantation development, trainings should be given to the poor farmers who will be allocated the land that already prepared. This may include that of entrepreneurship as well as technical skills for on-farm and off-farm activities, and may not limited for estate crops but also other crops possible to be grown on the home yards such as vegetables and "palawija" (cash crops). This would to some extent help reducing the severity of poverty.
- 5) Lastly, infrastructures, especially the basic ones, must be developed not only by the district government of Siak but also by the provincial government of Riau as well as the central government accordingly. The availability of infrastructure is a necessary condition for developing the plantations and other industries particularly if investors from other regions or country are sought. For this reason, the KIB should be developed at least simultaneously with the plantations or other agrobased industries.

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