Available online @ www.iaraindia.com / www.selptrust.org
SELP Journal of Social Science - A Blind Review & Refereed Quarterly Journal
ISSN: 0975-9999 (P) 2349-1655 (O)
Impact Factor: 3.655(CIF), 2.78(IRJIF), 2.77(NAAS)
Volume. IX, Issue 39
October - December 2018
Formally UGC Approved Journal (46622), © Author

THEORY AND PRACTICES OF CONTRACT FARMING IN INDIA

Dr. HARISH N
Lecturer in Economics
Adarsha PU College, Bengaluru, Karnataka-560032

Abstract

The developments in the field of marketing, food habits, technology, and agriculture in the new economic environment have brought about a new arrangement in raw material production and procurement known as contract farming. Under the contract system, a farmer agrees to supply a pre-agreed quantity of a certain quality produce at a pre-agreed price and time, to the processing or marketing firm, which may or may not provide certain facilities like provision of inputs, finance, etc. Contract farming can be defined as a system for the production and supply of agricultural and horticultural produce by farmers/primary producers under advance contracts, the essence of such arrangements being a commitment to provide an agricultural commodity of a type, at a specified time, price, and in specified quantity to a known buyer. In fact, contract farming can be described as a halfway house between independent farm production and corporate/captive farming and can be a case of a step towards complete vertical integration or disintegration depending on the given context. This paper examines the logic of contract farming (section 2), and its practice and implications from the producers' and the local economy's point of view with the help of an exhaustive review of various strands of literature (section 3). It also discusses the Indian experience of contract farming (section 4) and concludes by examining some possible alternative institutional mechanisms to use contracting as a developmental vehicle (sec 5).

Keywords: Contract Farming, Contracts, Growers, Practice, Firm etc.

Introduction

The developments in the field of marketing, food habits, technology, and agriculture in the new economic environment have brought about a new arrangement in raw material production and procurement known as contract farming. Under the contract system, a farmer agrees to supply a pre-agreed quantity of a certain quality produce at a pre-agreed price and time, to the processing or marketing firm, which may or may not provide certain facilities like provision of inputs, finance, etc. This is happening as good quality, timely raw material is a pre-requisite for any successful agribusiness firm, whether operating in the domestic or international market. It is important to recognize that this reorganization or restructuring of the agricultural production sector is taking place due to policy and market changes outside the sector i.e. in the industrial and trade sectors, and, these macro-policy changes drive micro-changes like contract farming which have the potential to change the production structure and relations of production in the agricultural sector. As a part of the internationalization process in agriculture which involves production, capital, and trade, contract farming encompasses all the three dimensions through intervention in input supply and production decisions, supply of capital and finance, and global marketing of agro-products. In fact, it is nothing but an extension of the phenomenon of global sourcing wherein a firm can produce anything anywhere, by sourcing inputs from anywhere, to be sold in any market in the world.

The proponents of agribusiness promotion argue that contract farming leads to big jumps in incomes and employment in agriculturally backward regions and brings a break from low levels of productivity and instability in production, thus putting the local economy on a dynamic path of growth and development. This is possible not only because of the technological and capital resources of these firms, but also because of the international character of agribusiness processes, which gives access to international markets. The agribusiness firms take risk by undertaking new projects in processing and marketing and provide a stream of cash flow to the local economy. This brings not only benefits to the local economy but also helps earn foreign exchange and increase food supply nationally and locally (Williams and Karen, 1985; Leisinger, 1987; Benziger, 1996). Contract farming has also been used to promote new high value crops which are more input intensive, risky, high-tech, and market dependent for profitability, to lower costs either by yield improvement or cutting input costs through better extension, and to raise returns by value addition to primary produce (Benziger, 1996; Singh, 2002). However, it is important to recognise the role of the state in encouraging or discouraging the agribusiness firms and in protecting the producers in contract situations (Asano-Tamanoi, 1988; Christensen, 1992; Grosh, 1994; Benziger, 1996). There is also a need to look at the potential role of agribusiness more specifically for different commodity sectors and regions, and not as a blanket solution since there are certain sectors which may require a more effective public sector or state intervention especially in technology and institutional innovations, instead of a private agribusiness effort (Christensen, 1992). But, looking at agribusiness growth from a different perspective (political economy) makes it clear that it is nothing but a process of industrialization of agricultural and rural production which takes place through simultaneous processes of appropriations and substitutions. Whereas appropriations operates as a process of exploitation of land and other biological sources of supply by the application of modern and advanced technology to get more and cheaper raw materials, substitutions operates as a process which tries to move industry or agribusiness away from direct and linear dependence on crop and other direct sources of raw materials by way of application of technology to create new products and sources of products. Thus, the two processes are contradictory to each other though they are driven by the same agribusiness sector and forces. Further, the application of biotechnology accelerates these processes and leads to what can be called bio-industrialisation (Goodman et al., 1987). In fact, contract farming directly promotes the process of appropriations. Further, contract farming is more like the practice of subcontracting in the industrial sector where large firms can farm out many production activities to small firms and benefit from lower costs and better skills (Wilson, 1986; Watts, 1992; White, 1997).

Given the failure of government mechanisms to support agriculture, and wide support for contract farming under the Structural Adjustment Programme (SAP) and liberalisation policies everywhere, in the presence of promotion of contract farming by the international development agencies like the World Bank, the USAID, the IFC and the CDC (Little and Watts, 1994; White, 1997), it is inevitable that new forms of contracts will be tried by the agribusiness firms as it is the only way to ensure quality and timely availability of raw material for processing, especially when, in some countries like India, captive farming is not allowed legally under Ceilings on Land Holding Act. Besides, captive farming means putting large resources in raw material production which may not be the best economic option for many agri-business firms especially small scale ones. Since contract farming also leads to changes in the way agricultural production, processing and marketing are organised (White, 1997), it is important to understand its practice and dynamics. This paper examines the logic of contract farming (section 2), and its practice and implications from the producers' and the local economy's point of view with the help of an exhaustive review of various strands of literature (section 3). It also discusses the Indian experience of contract farming (section 4) and concludes by examining some possible alternative institutional mechanisms to use contracting as a developmental vehicle (section 5).

The Logic of Contract Farming

Contract farming can be defined as a system for the production and supply of agricultural and horticultural produce by farmers/primary producers under advance contracts, the essence of such arrangements being a commitment to provide an agricultural commodity of a type, at a specified time, price, and in specified quantity to a known buyer. In fact, contract farming can be described as a halfway house between independent farm production and corporate/captive farming and can be a case of a step towards complete vertical integration or disintegration depending on the given context. It basically involves four things – pre-agreed price, quality, quantity or acreage (minimum/maximum) and time. From a developmental intervention point of view, it is a situation in which the relationship between the agribusiness firm and the farmers takes the form of an expert endowing the apprentice with resources, knowledge and skills. Or alternatively, it is more a case of bringing the market to the farmers which is navigated by agribusiness firms (Christensen, 1992). Contract farming is known by different variants like centralised model which is company-farmer arrangement, outgrower schemes, which is run by government/public sector/joint venture, nucleus-outgrower scheme involving both captive and contract farming by the contracting agency, multi-partite arrangement involving many types of agencies, intermediary model where middlemen are involved between the company and the farmer, and satel - lite farming referring to any of the above models (Eaton and Shepherd, 2001; GoI, 2003). In fact, contract farming varies depending on the nature and type of contracting agency, technology, nature of crop/produce, and the local and national context. Contracts could be of three types; (i) procurement contracts, under which only sale and purchase conditions are specified; (ii) partial contracts, wherein only some of the inputs are supplied by the contracting firm and produce is bought at pre-agreed prices; and (iii) total contracts, under which the contracting firm supplies and manages all the inputs on the farm and the farmer becomes just a supplier of land and labour. The relevance and importance of each type varies from product to product and over time these types are not mutually exclusive (Hill and Ingersent, 1987; Key and Runsten, 1999). Whereas the first type is generally referred to as marketing contracts, the other two are types of production contracts (Scott, 1984; Welsh, 1997). But, there is a systematic link between product and factor markets under the contract arrangement, as contracts require definite quality of produce and, therefore, specific inputs (Scott, 1984; Little and Watts, 1994). Also, different types of production contracts allocate production and market risks between the producer and the processor in different ways.

Understanding Contracts

Since the system of contract farming has its influences on the entire local and regional economy, all producers and organisations have to recognize the intervention of such a system and bear the consequences. Even for individual farmers, it is not contract per se but the relationship it represents, which is crucial as the divergence between the two may prove crucial in determining the development of contract farming as an institution (Clapp, 1988; White, 1997). Further, it is the context of the contract which can make a whole lot of difference as there are many actors and factors in the environment which influence the working and outcome of contracts and lead to a culture of contracting which is location and community specific. The way farmers perceive contract farming, i.e., define their relationship with companies, differs in each cultural context (Asano-Tamanoi, 1988; White, 1997). In fact, there is so much diversity in the type of firms, farmers, nature of contracts, crops, and socioeconomic environment that it is better to focus on specific situation than the generic institution of contract farming (Little, 1994; White, 1997). Some others argue that contract farming should be viewed as a cultural and historical phenomenon rather than as an imposed legal category of relationships as these contexts determine the response of the farmers to the new arrangement (Asano-Tamanoi, 1988).

Nature of Contracts

Contracts differ in their nature and effect due to the variations in the nature of crops, contracting agencies, farmers, crop technology, and the context in which they are practiced. Even within a crop, different companies can have different types of contracts. For example, contract systems adopted by different seed companies in India differ in their provisions as far as relationship with farmer is concerned (Shiva and Crompton, 1998). A review of evidence reveals that farming contracts are generally oral or unwritten, if written then in non-local language, and are quite loose in their specifications. For example, seed companies in India do not have written contracts, and do not even guarantee a price, though the farmer is assured of a profit in terms of seed being bought at a rate higher than the market price of the grain. Some of them do not even assure of the purchase of seed (Shiva and Crompton, 1998). Only a delivery slip or a credit/ seed/seedling slip is the proof of the contract a grower has. Contracts are highly biased against the growers. The company obligations are not specified. The contracting agencies end up rejecting low quality produce without any compensation for the grower, and the defaulters, on the other hand, are expelled from future contracts. Firms favour large farmers for various reasons, discussed in the following paragraphs, and finally large farmers also become dependent on these firms due to large volumes of produce they grow (CDC, 1989; Little and Watts, 1994). In Jamaica, the state Tobacco Industry Control Authority (TICA) guaranteed a minimum price of tobacco before planting, paid for the produce delivered within two weeks, deducted all input costs from the payment for the produce, and distributed bonus as and when warranted, under contracts. On the other hand, the MNC (CCJ) worked with selected growers including former company employees, provided all the inputs, and had total control over farming operations, though it did allow diversified cropping by the growers and ensured farmer participation in management of contracts through grower committees (Lewis, 1985). Plantation contracts are much more stringent in that the quality standards are tough, companies control plantations, and a very early advance notice (three years) is necessary to withdraw from contracting for both the parties. The company can refuse to procure produce and the growers are not even allowed to grow food crops (Sachikoyne, 1989; Porter and Phillips-Howard, 1995). Generally, grower's fixed price is the price formula followed in most contracts, though there are other possibilities like processor's fixed price, sharing of profits between firm and farmers, and administered prices which are rarely practiced in contract situations (CDC, 1989; Little and Watts, 1994).

Nature of Contract Growers

Contract farming may involve medium or large capitalist farmers relying on wage labour, small peasant producers who depend, to a larger extent on family labour, and even landless who lease in land for contract production as was the case in Thailand and India (USAID, 1994; Singh, 2002). But, agribusiness corporations tend to prefer large farmers for contract farming because of their capacity to produce better quality crops due to the efficient and business-oriented farming methods, large volumes of produce which reduces the cost of collection for the firm, their capacity to bear risk in case of crop failure, and various services provided by these large producers like transport, storage, etc. (Wilson, 1986; Winson, 1990; Key and Runsten, 1999). This happened in Australia where the MNCs started working with only large producers and rationalized the grower numbers as soon as the government withdrew from contract regulation. Also, the companies resorted to growers groups and group contracts to reduce farmer freedom to hold multiple contracts which was prevalent earlier (Burch and Pritchard, 1996). As a result of contracting, the number of potato growers declined from 7000 in 1950s to just 550 in the 1990s (Fulton and Clark, 1996). On the other hand, small farmers are picked up by firms for contracts only when the area is dominated by them, there is government directive to do so or they are found to be low cost producers in certain areas and crops (CDC, 1989). Further, firms may work with small farmers to make use of the state support (financial and technical) to these producers under various development programmes (Glover and Kusterer, 1990), and to benefit from lower cost production on these farms as these farmers have access to cheaper family labour, and being residual claimants of their labour, work more conscientiously than hired labour (Key and Runsten, 1999). Companies often engage local procurement agents, NGOs, and state agencies as intermediaries to procure and to enforce contracts respectively (Clapp 1988; and USAID, 1994). In fact, some of them even use large growers, rural elite, and local small processors as sub-contractors to procure from the small growers for the company (Kirk, 1987). The seed companies in India use small companies as sub-contractors to procure seeds produced under contracts (Shiva and Crompton, 1998).

Conclusions and Policy Suggestions

Given the nature of modern farming involving tremendous amount of technological input and market orientation which require capital resources, it is but inevitable to involve private corporate business interests in agricultural development through contract farming system. The above discussion suggests that it is not the contract per se which spells hardship or doom for small growers as a system, but how it is practised in a given context. In fact, all over the world, contracting of some kind is a necessity for many or most forms of modern commercial agriculture. Though there are some scholars who caution about the widespread applicability of contract farming as a development tool (Glover, 1987), if there are enough mechanisms to monitor and use the contract for developmental purposes, it has the potential to lead to a betterment of all the parties, especially the small and marginal farmers.

The important question is that of the division of value added between the firm and the farmers which is based on the relative bargaining power of the parties involved (White, 1997). Therefore, it is important to examine carefully and design the pricing and other aspects of the contracts. There is a role for the state agencies and the NGOs to intervene in contract situations as intermediaries to protect the farmer and broader local community interests. The NGOs can also play a role in information provision, and in monitoring and regulating the working of contracts. Better co-operation and co-ordination between companies and co-operatives for agricultural development also needs to be encouraged. Further, both companies and state should promote group contracts with the intermediation of local NGOs and other organizations and institutions so that contractual relationships are more durable, enforceable, and fair. An insurance component in farming interventions is a must to protect the farmer interest and it is noted that some companies are already doing it. But, the most important thing is to ensure market for the farmer produce at better price under these agribusiness projects. What is also required is marketing extension in terms of better product planning at the farmer level, provision of market information, securing/ accessing markets for farmers, provision of alternative markets and market orientation in terms of improved marketing practices at the farmer level (Patnaik, 2003). Government should also play an enabling role by legal provisions and institutional mechanisms, like helping farmer co-operatives and groups, to facilitate smooth functioning of contract system.

References

1. Channaveere Gowda B N (2012). Economics of Contract Farming in Indian Agriculture. Serials Publication New Delhi.
2. Dileep, B, K. R. K. Grover., and K. N .Rai. (2002). Contract Farming in Tomato: An Economic Analysis. *Indian Journal of Agricultural Economics, April-June Vol*. 57, No.2.
3. Fulton, Amabel L. A. and Clark R. J. (1996). Farmer decision making under contract farming in Northern Tasmania. In: D. Burch. R. E., Rickson and G. Lawrence (Eds.): *Globalization and Agri - food Restructuring – Perspective from the Australia Region*, Averbury, Brookfield, USA, 219-237.
4. Ghee, L. T., and Dorall, R. (1992). Contract farming in Malaysia: with a special reference to FELDA land schemes. *Contract Farming in South Asia* edited by D. Glover and L. T. Ghee. Institute for Advanced Studies, University of Malaysia, Kualalumpur, 71-119.
5. Glover, D. & Kusterer, K. (1990). Small Farmers, Big Business: Contract Farming and Rural Development. *London, Macmillan*.
6. Glover, D. (1984). Contract Farming and Smaller holder out grower Schemes in the Less Developed Countries. *World Development*, 1143-1157.
7. Hill, B, E. and Ingersent, K. A. (1982).An Economic Analysis of Agriculture. *London Heinemann.*
8. Kiresur, V, R.Paril, S, A. and Vijayakumar,

A, S. (2002). Contract Farming Opportunity for Small and Marginal Farmers in the context of Trade Liberalization, P-II. *Agricultural Economics Research Review*, 78-87.

9. Little, P, D. & Watts, M, J. (1994). Living under Contract: Contract Farming and Agrarian Transformation in Sub-Saharan Africa. *Madison University of Wisconsin Press*.
10. MRK Murthy .S. Bindu Madhuri. (2013). A Case study on suguna poultry production through contract farming in Andhra Pradesh. *Asia Pacific Journal of Marketing & Management Review*, 2 (5): 58-68.
11. N. Nagaraj, M.G. Chandrakanth, P.G. Chengappa, H.S. Roopa and Pramod M. Chandakavate. (2008). Contract Farming and its Implications for Input-supply, Linkages between Markets and Farmers in Karnataka" *Agricultural Economics Research Review*. 21: 307-316.
12. Nanda and Meera. (1999). Trans nationalization of third world state and undoing of green revolution. *Economics and Political Weekly*, 30(4). 20-30.
13. Nasheman Bandookwala and Mala Sharma. (2013). Avenues of Contract Farming in Gujarat: A study of Potatoes. *Indian journal of applied research. 3 (1)*.
14. R. S. Deshpande. (2008). Contract farming and tenancy reforms- Entangled without tether. *Concept publishing company, New Delhi*.
15. S. Earappa. (2006). Contract farming in Karnataka: A boon or bane? *Research report:* IX/ADRT/113, *Agricultural Development and Rural Transformation Centre Institute for Social and Economic Change Nagarbhavi, Bangalore*.
16. Sukhpal Singh. (2003).Contract Farming in India: Impacts on Women and Child Workers. *International Institute for Environment and Development Natural Resources Group and Sustainable Agriculture and Rural Livelihoods Programme*, 1-16.
17. Singh Sukhpal. (2000). Theory and Practice of Contract Farming: A Review, *Journal of Socio -Economic Development.* 2(1): 228-246.
18. Singh, Sukpal. (2000).Contract Farming and Agricultural Diversification in the Indian Punjab: A Study of Performance and Problems, *Indian Journal of Agricultural Economics*, 55(3), July-September, 283-294.
19. Working group report of the sub-commission of National Development Council (NDC). (2006). on agriculture and related issues. Planning commission, New Delhi
20. White Ben. (1997). Agro-industry and contract farming in upland java. *The Journal of Peanut Studies*, 23(3), 100-136.