CONTRACT FARMING –PROS AND CONS IN INDIAN AGRICULTURE SYSTEM

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ABSTRACT

Contract farming is one of the different governance mechanisms for transaction in agro-food chain.

In Contract farming agricultural production carried out according to an agreement between buyers and farmers which establishes the condition for production and marketing of the farm products. .In the era of liberalization, globalisation contract farming is effective way to coordinate and marketing in agriculture but there will be problems related to the small scale farmers, women, and child labour. So contract farming has several pros and cons in context of developing country like India. The advantages and problems of contract farming in Indian agriculture system are mentioned in this study. The content analysis on the previous literature is used as methodological framework in this study.

Key Words: Agriculture, Agro-business, Contract farming, Globalisation, Small scale farmers.

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INTRODUCTION

In the environment where the policies of liberalization and globalization exist, the role of State in agricultural marketing and input supply is being reduced and an increasing space is being provided to the private sector for bringing better market efficiency in the input and output markets, and also brought a new arrangement in raw materials production, which can be known as contract farming system. In other words it is a "substitution of a market, which establishes a relation between producers/farmers in agriculture and processor or marketing firms (Agro-industry) to produce and to supply agricultural product under pre-agreed price. Contract farming is the farm-firm linkage wherein the production and marketing of agriculture produce is coordinated and promoted. It is an agreement between farmers and processing or marketing firms for production and supply of agro- products under forward agreement. In others words, it is a binding arrangement between a firm (contractor) and an individual producer (contractee) in the form of a 'forward agreement' with well-defined obligations and remuneration for operation done, often with specifications on product properties such as volume, quality, and timing of delivery" (Catelo and Costales, 2008) "Contract farming" creates a dynamic partnerships between private capital and small holders, which will lead to technology transfer, innovation and market growth. Further it is a vertical coordination between growers of an agricultural product and processors of the product**.** Since from the process of integration of economy with the world economy started post 1991, there has been improvement to several operations that are the main agents of the economic growth and at the same time there are some drawbacks also came into existence. As liberalisation and globalisation in rural parts of the developing country like India has leads to increase in the contract farming arrangements, wherein the land owners are the beneficiary as they have contract with agribusiness marketing or processing firms who specify the prices or acreage to be delivered and the workers employed by the contract producers tends to experience poor terms and condition (T&C) with the labourers.**(**Sukhpal Singh,2003**)** Further there is increases incidents of the child labour especially girl child preferred by the employer because of their docility, obedience and nimble fingers. **(**Pearson, R; 1998). On the small-scale farmers front in respect of the contract farming (C.F), in the developing countries like India small scale farmers face several constraints that limits their potential to increase their productivity and their income i.e. they lack information about production methods for the crops that normally the farmers do not grow, lack of necessary financial reserves due to high interest rates demanded. Small scale farmers engage in contract farming arrangements as to start cash crop production, particularly when cash crop is of high value, so by this they gain access to credit, inputs and technical assistance. On other hand, contract farming shift farm production to cash crop may adversely affect the production of basic food crops and also it may narrow local farm markets resulting from agricultural resources being diverted to contract farming (Jos Bijman, 2008). Further the agribusiness companies working with farmers are driven by profit motive alone most of time and therefore tends to ignore the social dimension of their operations. E.g. they may abandon an area if not profitable to them, and exclusion of small and marginal farmers from there operation (Andreas, S., et al., 2006).

HISTORY OF CONTRACT FARMING

Contract Farming can be traced back to colonial period when commodities like Collin Indigo were produced by the Indian farmers for English factories. Seed production has been carried out through contract farming by the seed companies quite successfully for more than four decades in the country. In year 2000 the new agricultural policy sought to promote growth of private sector participation in agribusiness through contract farming and land bearing arrangements to accelerate technology transfers, capital inflows and assured market for crops. The colonial period saw the introduction of cash crops such as tea, coffee, and rubber, poppy and indigo in various parts of the country, mostly through a central expatriate-owned estate surrounded by small out growers' model. In year 1920s ITC introduced cultivation of Virginia tobacco in Coastal Andhra Pradesh, incorporating most elements of a fair contract farming system and met with good farmer response and that was replaced by auctions in 1984. Contract farming has been used for seed production since the 1960s and is now widely utilised for the production of poultry, dairy products, potatoes, rice and spinach, among other things (Rehber, 2007). The PepsiCo introduced tomato cultivation in Punjab in the 1990's under farming to obtain inputs for its paste-manufacturing facility established as a pre-condition to its entry in to India. This was sold to Hindustan Lever in 2000, which had earlier acquired the kissan Karnataka. Contract Farming was the strategy of choice for almost all food processing projects contemplated in the 1980's and 1990's.Contract Farming is again vogue, and even tried for bulk production of subsistence crops, such as paddy rice, maize and wheat. Commodity co-operatives, which emerged in the 1950,s, provided most services envisaged under ideal contract farming to their members and bought back the supplies offered at contracted prices, although these were not strictly contract arrangements. The succeeded enormously, leading to their replication and compelling private companies also to adopt similar approaches. Contract Farming is now considered to be a corrective to market imperfections and serving a useful purpose in India in its own limited sphere.

Contract Farming has been promoted in the recent three decades as an institutional innovation to improve agricultural performance in less developed countries. So the system of contract farming was accepted and were used as for the institutional frameworks as to deliver the price incentives, technology and other agricultural inputs. Several bodies such as (Local Governments, private firms, MNCs and some other international aid and lending agencies have been involved in these contract farming schemes. (Glover 1984).

KINDS OF CONTRACT FARMING

Mighell and Jones, 1963 indicated three conventional types of agricultural contracts-

a) Market-specification contracts: Market specification contracts are those, which guarantee a farmer a marketing outlet and time of sale, and possibly a price structure, if some degree of quality is met.

b) Resource-providing contracts: Resource providing contracts are those, where certain physical or technical inputs are provided by a firm, with the requirement that produce is marketed through that same firm.

c) Production-management contracts: Production-management contracts are those where the firm stipulates and enforces conditions of production and farm-based processing.

CONTRACT FARMING MODELS

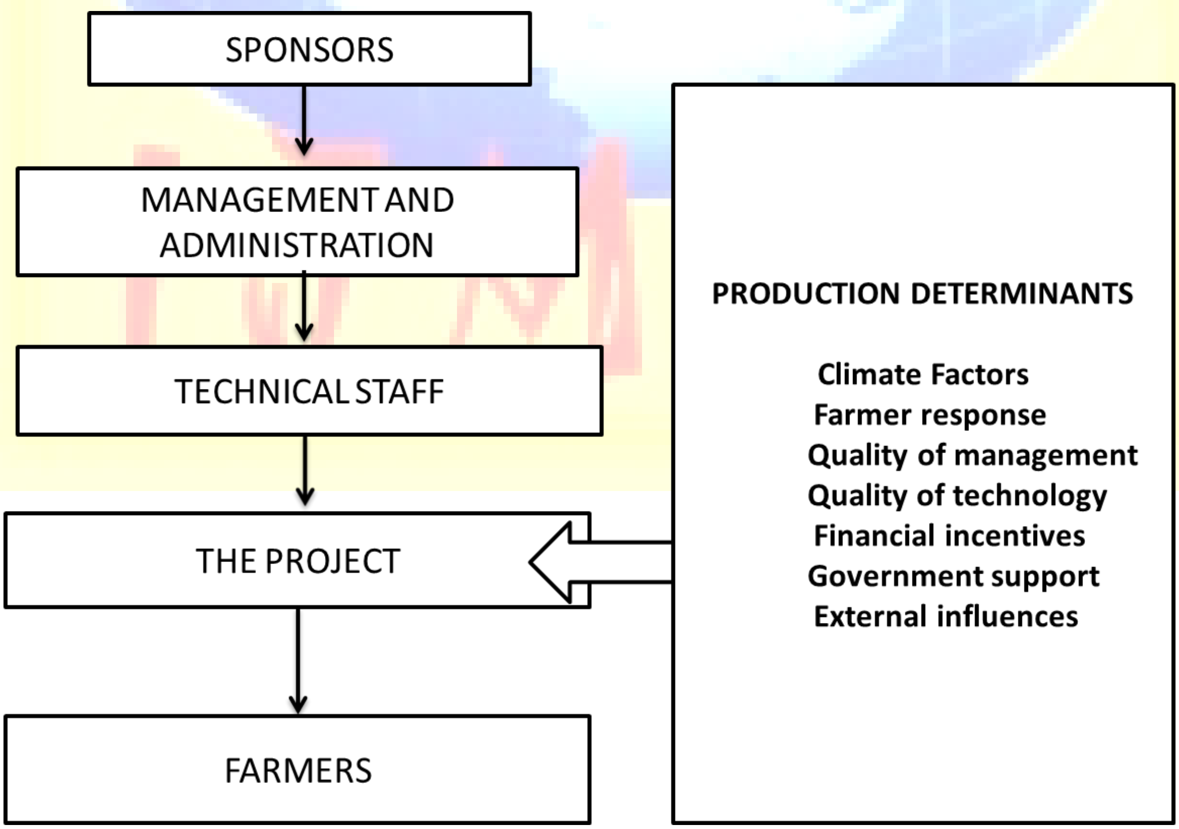
Eaton and Shepherd 2001, in their FAO manual for contract farming distinguish between five Models these models differ in the type of contractor, the type of product, the intensity of vertical Coordination between farmer and contractor, and the number of key stakeholders involved.

These

models are accepted globally.

1) Centralised model:

In this model there is strict vertical coordination as shown in fig -1, which means that quality is tightly controlled and quantity is determined at the beginning of the growing season, here the processor buys produce from a large number of small farmers. The sponsor may purchase from tens of thousands of small-scale farmers within a single project. The centralized scheme is generally associated with tobacco,
Cotton, sugar cane and bananas and with tree crops such as coffee, tea, cocoa and rubber, but can also be used for poultry, pork and dairy production. On other hand, where fresh vegetables and fruits are grown under contract, the term "processing" may include grading, sorting and packaging as well as the provision of cool storage facilities. In Africa, the contracting out of crops to farmers under centralized structures is common. These are often called "out grower" schemes.



Source: FAO Agricultural Services Bulletin: Charles Eaton and Andrew W. Shepherd (assessed on 11 February 2013)

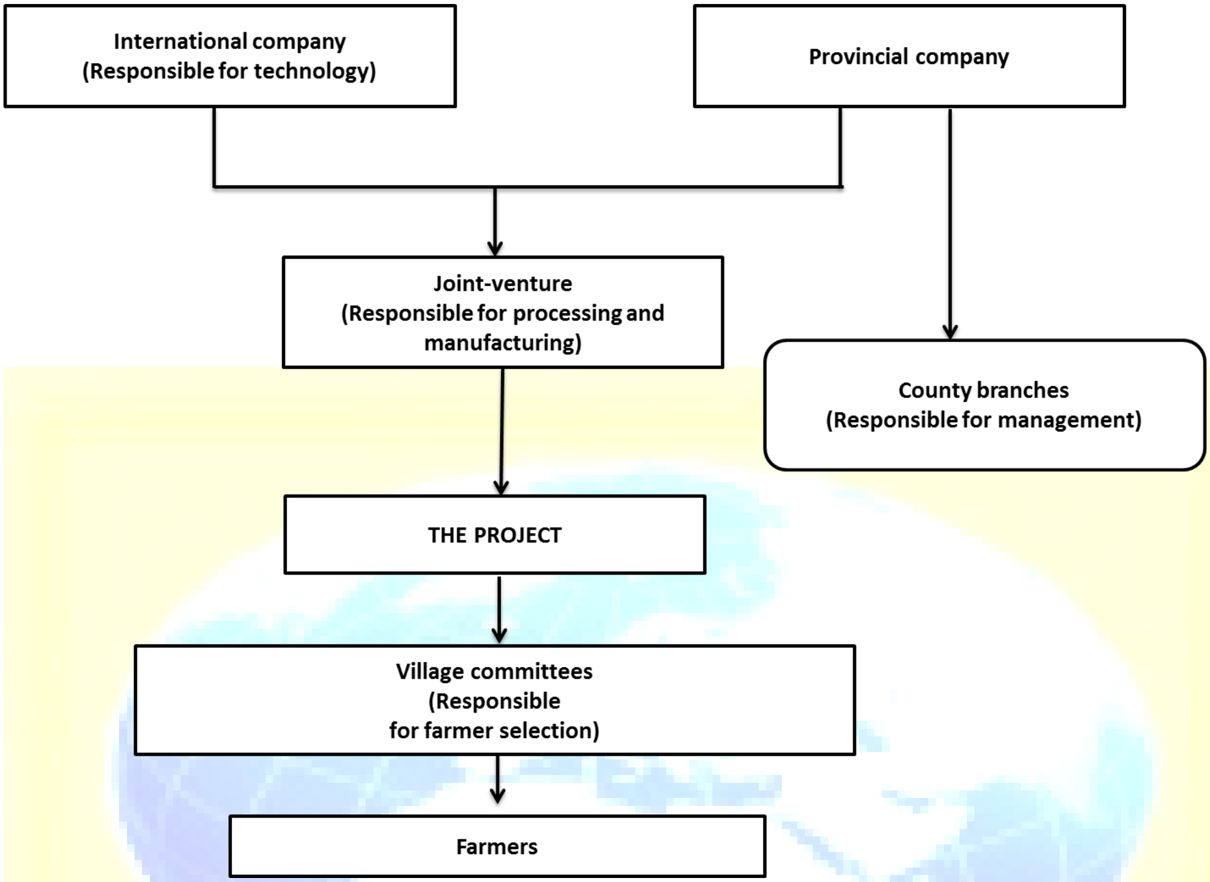
Fig.1- centralised model

2) Nucleus Estate Model:

Under this model the contractor not only sources from independent farmers but also has its own production facilities (an estate plantation). The central estate is usually used to guarantee throughput for the processing unit but is sometimes used only for research and breeding purposes. Contractors often used to be_state owned farms that have reallocated land to former workers. This model is mainly used for_perennial crops, but there are examples of applications of this model in other crops. Eaton and Shepherd
(2001: 50) give an example of a dairy nucleus estate in Indonesia where the central estate is primarily used for the rearing of "parent stock". Vertical coordination in this model varies.

3) Multipartite Model:

The multipartite model usually involves statutory bodies and private companies jointly participating with farmers. Multipartite contract farming may have separate organizations responsible for credit provision, production, and management, processing and marketing. The model may have separate organizations responsible for credit provision, production, and management, processing and marketing of the produce. In year 1990, many governments in developing countries actively invested in contract farming through joint ventures with private companies (Little and Watts, 1994).



Source: FAO Agricultural Services Bulletin: Charles Eaton and Andrew W. Shepherd (assessed on 11 February 2013)

Fig.2- Multipartite Model

4) Informal model:

This model is characterised by informal production contracts of the individual entrepreneurs or small companies with farmers on a seasonal basis for crops such as fresh fruits and vegetables. The crops usually require only a minimal amount of processing or packaging for resale to the retail trade or local markets.

5) Intermediary model:

This model as a combination of the centralized and informal models, is common practice throughout

Southeast Asia, there are three parties to the CF arrangement namely-

- Processor
- Collector (or middlemen)
- Farmers.

A processor or major trader formally contracts with a collector (or middlemen) who then informally contracts with a number of farmers. This model has got one disadvantage that there is the break in direct link between contractor and farmers.

SMALL SCALE FARMERS UNDER CONTRACT FARMING

The small scale farmers enters into arrangement of the contract farming because of the motivating factors, that they may be benefitted from contracting by way of reduced risk in production and marketing and improve access to inputs , technical assistance and credit**.** Masakure & Henson (2005) explored four motivating factors of small farmers to contracting namely reduced market uncertainty, knowledge acquisition, income benefits, and intangible benefits (status). In the study of contract farming by Guo, H., R.W. Jolly, and J. Zhu; (2005), found that small scale farmers enters the contract farming agreement in order to gain the advantage namely price stability, market access, and technical assistance to improve the quality. Further the inter linkage or inter locking between input and output markets one of the key element of contract farming in developing countries (Dorward, A.,J. Kydd, and C. Poulton, Eds;1998). The inter linkage of inputs and outputs market provide coordination between farm-firm linkage i.e. on entering into C.F arrangements the contractor provides right inputs and technical assistance to small scale farmers ,to which they often do not have access to credit and technical assistance for the products which are not well developed from the government, Further**(** Dorward et al;1998: 257) identified several conditions related to the market structure before the inter linkage or inter locking contract so that contractor and contractee both would be beneficial. The condition are-

1) Strong demand for crop output

2) Competition among traders
3) Effective repayments incentives

Strong demand for crop output

There must be strong demand for the crop output in the market and provide incentives to those traders who have access to capital.

Competition among traders

There must be competition among the traders in order to prevent small farmers being locked up into unequal relationship with the particular contractor

Effective repayment of incentives

Farmers must face effective repayment incentives **i.e**. if they default on a loan, then they incur a loss of earning. This requires that crop provides them with better return than other opportunities of income.

Negative impact of contract farming and government role

There are some recent studies, facilitated by large scale surveys, which assess the role of contracting but also producer and marketing organisations (cooperatives, etc.) in linking small farmers to global markets. For example, Patrick (2004) studies contracting in Indonesia, Guo et al. (2005) analyse the situation in certain provinces in China and Sautier et al. (2006) focus on parts of Africa.

Similar studies have been also undertaken by governments themselves. For instance, the Government of India (2007) has addressed contracting issues within its five year plan. The report noted that contract production gave much higher returns as compared to non-contract situation, but it also cites examples of contracting working to the disadvantage of farmers in cases where buyers' power increased "disproportionately". The report also tended to confirm that contracting agencies typically prefer large farms given their capacity to produce better quality crops due to more 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.

Sometimes, it may happen that there is loss of autonomy i.e. increasing dependency and chance of becoming exploited with increasing production risk. (Singh, 2002; Kirsten and Sartorius, 2002). In India, contract farming agreement is often verbal in nature and that do not provide legal protection to the small farmers and sometime, the either party may breach the contract, there has been some instances of farmers refusing to sell to the contracting firms in case when market price exceeds contract price (Mp > Cp) and on contrary the firms might renege on contractual terms, refusing to purchase contracted quantities and avoid transparency in the price determination mechanisms of the contract, making the small farmer difficult to access whether he received the proper remuneration due to the fluctuations in the market conditions (Gulati, Ashok. 2008).. Most of the negative effects of the contract farming is the result of the fact that the relationship of the small farmers (contractee) and the firms (the contractor) are uneven. The firms (contractor) often exercise the position and power and other non-competitive conducts in imposing the terms of contract. (Porter, G. and K. Phillips-Howard; 1997). So the contract farming is sometimes biased and criticized as it goes mostly in favour of firms and by exploiting the poor bargaining power of the small farmers. The government can act in ameliorating the negative effects of contract farming by the way, Firstly, creating the scale effect and also enhance the bargaining position of the small farmers. Secondly, by regulating the market through enactment of competition policies, special contract law and provision of low cost arbitration. Thirdly, by giving direct subsidies to small scale farmers. (Eaton, C. and A.W. Shepherd; 2001).

Positive impact of contract farming

(Minot, 2007), indicated that market-specification contracts reduce co-ordination costs, particularly for perishable products or those with complex quality attributes, through addressing marketing information asymmetries. And farmers retain full control over production further the importance of contract farming viz-a-viz resource-providing contracts reduce the farmers' cost of choosing, accessing and purchasing inputs, and the firm is assured quality of produce and (usually) repayment. Resource providing contracts are often used for crops that require specific inputs or quality standards and in circumstances when farmers struggle with imperfect input markets.

(Jos bijman, 2008), outlined several advantages of the contract farming in respect of small farmers and firms. Firstly, contract farming helps in improvement in market assessment and reduction in transaction cost. Secondly, contract farming assists by reducing the production risks through the provision of inputs by the contractor i.e. Failures in input markets are circumvented by such direct provision and the economies of scale allowed by the larger purchases of inputs by the contractor can be passed on to farmers via, reduced costs. Thirdly, contract farming helps in easy access to credit for the small farmers i.e. under a resource providing contract, working capital is supplied in kind, via input provision, by the contractor. Such transaction is guaranteed by the commercial commitment between farmer and contractor. By the same token, access to credit for both working capital and fixed capital is enhanced in the case of market specification contracts, because banks may accept the contractual commitment as a sufficient guarantee for the granting of loans. Fourthly, through contract farming (C.F), the contracter provides the technical assistance to contractee and in turn gets the more uniform products, which are of great importance to processing industries. These advantages of contract are particularly relevant when farmers choose to produce specialties, as these high-value crops entail higher production and marketing risks and higher investments.

Private Sector Companies involved in Contract Farming in India

There are more than twenty five main contract firms in India as indicated by AGMARNET data (assessed on 13 February 2013) but the table is shown for only seven most effective firms that are doing the operations of agro-business.

Sr. no	Name of the Company	States	Commodity
1.	Appachi Cotton Company Zamin Uthukuli, Pollachi Coimbatore	Tamil nadu Karnataka	Cotton
2.	AVT Natural Products Ltd 72-E, Chesney Estate Ethiraj Salai Chennai 600008	Tamil nadu	Marigold Caprica Chilly

3.	Cargill India Pvt Ltd DLF Gateway Tower 11 & 12th Floor, DLF City, Phase III Gurgaon 122 002	Haryana	Wheat, Maize and Soybean
4.	Escorts Ltd Agri Machinery Group 18/4 Mathura Road Faridabad – 121007	Haryana	Basmati
5.	The Global Green Company Pvt Ltd (Naan) 220, Alembic Glass Complex Whitefield Hoskote Road Whitefield Bangalore	Karnataka, AP	Gherkin, Baby corn, Paprika
6.	Hindustan Lever Ltd 165/166, Backbay Reclamation Mumbai -40002	Maharashtra	Wheat
7.	Ion Exchange EnviroFarms Ltd Neeta Towers Pune-Mumbai Highway Dapodi Pune – 411012	Maharashtra	Organic Products of Banana, Pineapple, Papaya, Wheat, Basmati, Cotton

Source: agmarknet.nic.in/ (assessed on 13 February 2013).

Conclusion-

Contract farming arrangements in many parts of India leading to increase in contract farming arrangements where landlords or tenants have contract with agro- marketing firms who specify prices timing, quality etc. but the contract farming is not the panacea that will solve the problems of agriculture production but it could be evaluated as a way of providing early access to credit, factor input, technology and the output market for small scale farming structure. Contract farming might also be seen as a way or as a part of rural development and promoted to improve agricultural performance especially in developing countries. Besides farming to both sides there are some problems that are needed to be addressed for successful implementation of contract farming in India. And for the successful implementation of contract farming coordination and collaboration consciousness and acting in the organised manner are advisable for both sides. The government attitude and incentives is also important aspects for the successful farming through contract, the government agencies need to monitor working conditions and wage rates in contract farming in order to prevent of being exploited and the firms should also constantly work towards more ethical and humane labour standards.

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