CHAPTER IX:
LEGAL FRAMEWORK AND STATUTORY SAFEGUARD MECHANISM

The World Development Report (WDR) (2008) strikes an optimistic note on the potential for reducing poverty through contract farming where a firm lends inputs such as credit, fertilizer, seed and extension to a farmer, in exchange for exclusive purchase rights over the contracted crop. Contract farming is advocated as one of the panaceas for all the ills and poor development of agricultural community especially after the opening of Indian economy and the advent of globalization. The increased involvement of India into the affairs of World Trade Organization has intensified and brought to fore the role of the agribusiness firms who are entering into contract with primary producers and farmers for supplying raw materials. Goodman and Watts (1997) provide a broader picture of effects of international trade expansion in food products on the economic and social environments in developing countries. These studies show market liberalization is changing pattern of agricultural production in terms of on-farm crop and livestock mixes, increasing total production in physical and value terms and changing the types of food products entering international markets. The studies also show that traditional values and habits in agriculture are being replaced by transactions that increasingly reflect a ‘cash culture’.

There are diverse views on the merits and demerits of contract farming. Many argue that since the primary producers or the farmers lack the bargaining capacity to negotiate the contract, they often end up on the losing side by entering into contracts that are detrimental to their interests. 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).

There are also pertinent arguments to suggest that if contract farming is rooted in appropriate policy, statutory and institutional framework, it has tremendous potential to help the agricultural community in general and the small and marginal farmers in particular (Sukhpal Singh, 2005). The existing practices of contract farming and their implications on the farming community in India is a matter of great concern. Already most of the farmers in India are apprehensive due to mass suicide,
forceful land acquisition, and frequent crop failures. In the absence of any sound support from state or non-state actors the problems get complicated. In light of above problems, any adverse impact on the farmer due to Contract farming or related activities of backward integration, will have broad impact on all institutions of Indian society. India is predominantly an agrarian society with its majority population concentrated in rural area and engaged in agricultural activities. Indian agriculture is dominated by smallholders as of the total 101 million farm households 86 per cent have land holdings of less than or equal to 2 ha, and their average size of land holding is 0.53 ha (Government of India, 2006a).The overall condition of farmers in India is getting bad to worse. One of the major causes of remote or tribal belts' insurgencies and farmers' unrest in India is due to their deplorable conditions. Intervention of sound policies and a practical support for growth of agriculture is indispensable for inclusive economic development.

Several studies have proved that for successful contract farming, the nature and the practices of the 'contract' are central to the issue of contract farming. The important aspects are not only the drafting and transparency in the contract but also its' capacity to protect the benefits of the primary producers and farmers.

There is a need to have a comprehensive statutory protection from ill effects of contract farming for the farmers. But the practice of contract framing alone can also not be overemphasized and advocated vehemently. The agricultural co-operatives, the Non Governmental Organizations (NGOs) and the civil societies should also be given chance and the legal and regulatory system should enable them to play a prominent role in protecting the interests of farmers in contract farming.

9.1 Contract Farming in India

The Indian agro-food system is undergoing rapid transformation and there is growing evidence that Contract Farming (CF) will have an important role in this transformation. Contract farming usually involves the following basic elements - pre-agreed price, quality, quantity or acreage and a fixed time frame. Contract farming refers to a range of initiatives taken by private agribusiness companies to secure access to smallholder produce (Minot, 1986).

CF can be defined as a system for the production and supply of agricultural, horticultural or allied produce by primary producers under advance contracts.
Essentially, such arrangements include a commitment to provide a commodity of a type/quality, at a specified time, place, and price, and in specified quantity to a known buyer. In fact, CF can be described as a halfway house between independent farm production and corporate/captive farming (Singh, 2002).

CF is known by different variants like centralized model which is Company’s and farmer’s arrangement, out grower scheme which is run by government/public sector/joint venture, nucleus out grower scheme involving both captive farming and CF by the contracting agency, multi-partite arrangement involving agencies other than the grower and the buyer, intermediary model where middlemen are involved between the company and the farmer, and satellite farming referring to any of the above models (Eaton and Shepherd, 2001; Gol, 2003). The Contract Farming activities, vary and depend a lot on the nature and contracting agencies, technology employed in harvesting, perishability and other rules related to food quality and quantity available.

9.2 Legal Issues Involved In Contracts Farming

The details of contract contents and design have been prepared by Marta Doria, FAO volunteer, with additional contribution from Carlos A. da Silva (FAO – AGSF) when are presented below with some modifications:

9.2.1 Contract Design

While a sound design of the legal contract, does not by itself guarantee the success of a contractual relationship, the opposite is often true. Non observance of basic principles of contract creates risks for the contractual relationship. The following principles are usually recommended to be followed in contract design:

➢ The contract should be written to be binding. If the agreement between framers and firms is verbal only, it will invariably make them legally unbinding for the two parties.
➢ It should be written to be enforceable in a court of law.
➢ It should define the parties (seller-buyer, producer-processor, and supplier-purchaser).
➢ It should clearly specify the product under consideration (quality and quantity).
➢ It should state the time of delivery.
It should clearly establish prices, payment obligations and other financial issues. The parties should determine the price to be paid for the product transacted or establish the rules for its determination, including price adjustments for variation of quantity, quality and timing of payment where applicable.

- It should indicate the mutual obligations, specifying the responsibilities of both parties.
- It should have an indication of its duration.
- It should establish a legal instance to govern the contract (provincial state, country, etc.). If the two parties are located in different provincial states in one country, only one law should be chosen to be applied. It can simplify a dispute if it arises.
- It should refer to a dispute settlement mechanism or to an arbitrator to resolve dispute.
- It should have a signature clause.

9.2.2 The Legal Framework

Contracts should be designed and enforced under an adequate legal framework. The contracts will be governed by non specific general contract law.
Box 9.1. Legal framework for contract farming in Haryana state, India

Contract farming arrangements are rapidly emerging in India since the government decided to promote private sector participation in agricultural marketing. A law on contract farming in Haryana, an agrarian state in the north of the country, was on the anvil in 2003. In general, all Indian states are set to amend the Agricultural Produce Marketing Act (APMC). The “amended bill” was still on anvil in 2006. This was mainly to protect the interest of farmers and companies entering contract farming and to provide an effective dispute resolution system. The proposed Bill has the following characteristics:

1) It defines contract farming as an agreement by a producer (farmer) and a sponsor (contractor, firm, company) saying that the latter would purchase the produce of the former as specified in the agreement.

2) The Bill provides an institutional arrangement for registration of sponsoring and recording of the Contract Farming Agreement, indemnity to farmers’ land.

3) The Bill will be set up to take a decision in the case of disputes arising out of the contract farming agreement. The regulatory authority will resolve the dispute within 30 days after giving the parties a reasonable amount of time to be heard.

4) If the party is not pleased with the decision of the regulatory body, an appeal can be made within 30 days from the day of the decision. The appellate authority’s decision will be treated as a decree of the civil court.

5) The proposed Bill’s draft points out that disputes arising out of contract farming cannot be brought before any civil court.

9.2.3 Initial Costs of Drafting, Negotiating and Enforcement of Contract Farming

There is an initial cost of drafting contracts which gets increased by the necessity of having ‘first season contracts’ working well. Glover and Kusterer (1990) report that farm contracts have a ‘honeymoon’ period in their first season where smallholders show high levels of goodwill towards the contracting firm. However, smallholders’ experience of the first season flows into later seasons when, with contract maturity, contract provisions tighten and smallholder’s attitude hardens as a more business-like attitude develops. Hence, getting the contract ‘right’ in the first
season should be a priority for the agribusiness firm and likely to be costly. Upfront
costs in negotiating and managing contracts include:

- Costs of gathering agricultural, social and economic information about an area
  or region.
- Costs of contacting and establishing relationships with individual smallholders,
  farm groups and village committees or headmen. This may involve both
  political action and purchase of goodwill at the community level.
- Costs of gathering information on individual basis to select smallholders
  suitable, from the firm’s perspective, as partners in contracts.
- Costs of negotiating with individuals including possibly farm and family visits
  and establishment of personal relationships between smallholders and firm
  representatives.
- Costs of writing contracts and, where literacy is limited, legitimization of
  contracts through a village committee or headman.
- Costs of enforcement of contracts.

9.3 Enforcement and Dispute Settlement Mechanism

The enforcement of contracts is an important pre-condition for efficient
exchange and investments in economic activities in general and in agro-food in
particular. When a breach of contract happens, one or both the parties might wish to
enforce the agreement on its terms.

In developing countries enforcement institutions are often weak or absent.
India is not an exception to this rule. Government interventions to address such a
shortcoming are needed as a pre-condition for the development of a favourable
climate for business investments. Effective enforcement mechanism is important for
successful Contract Farming. Mediation, reconciliation, arbitration etc. should be
made to exhaust first before resorting civil court for dispute resolution.

A flexible contract may allow renegotiations and thus enable parties to adjust
the contract to changes in the environment. Ex-post discretionary adjustments and/or
renegotiations may work to implement and improve the contract, especially when they
are considered “incomplete”. The advantage is that parties can remove ex-post
inefficiencies through renegotiation. The disadvantage is that renegotiation reduces
commitment and may lead to opportunistic behaviour. If the parties know that the
contract can be renegotiated they may not care about the incentives in the initial
design, but just about the incentives they expect to receive in the renegotiated
contract. Hence, while desirable in principle, renegotiation can lead to ex ante
inefficiencies (Olesen 2002).

9.3.1 Alternative Dispute Resolution for Conflicts

Alternative Dispute Resolution (ADR) is how disputes can be negotiated and
resolved outside of the courtroom in a non-adversarial manner. ADR embraces a
myriad of mechanisms, approaches, and techniques. ADR typically includes
mediation, persuasion, collaborative law, and other methods. Trade agreements by
NAFTA and WTO have found that the successful functioning of these agreements
require all private and public parties to think carefully about resolving disputes ahead
of time and setting up a number of alternative processes to be used by the parties. The
ADR has become effective not only among private parties but also equally important
in Government-to-Government and other highly organized sectors.

There are several models which have been developed in the U.S., EU and
other countries which can assist in resolving agribusiness and food management
conflict resolution in rural as well as urban agro food communities. Indian judicial
system has also encouraged the use of ADR for mutual disputes. Many people fail to
realize that restructuring the trade and financial sectors (and many others) without
restructuring the judiciary will end in failure. (International Herald, 2000)

The need for alternative dispute resolution continues to grow, as well as the
need to empower the people. Arbitration which generally traders think of is just
another mode to redress disputes or viable alternatives for the trade disputes.
Arbitrator's clause is also like a judicial remedy and involves legal proceedings which
also become cumbersome and time taking. Unless it becomes inevitable one can
resort to arbitration only after exhausting the ADR. With no institution to keep a
check on the schedule of the arbitrators, they i.e. arbitrators become masters unto
themselves. Arbitral hearings are often as slow as the court hearings. One cannot
blame the arbitrators for that, as they are usually retired judges. Most of the Judges
are not aware of the procedures and know how attached with business deal. By and
large, in the initial period, the scheduled hearings are held only to give fresh dates of
hearings (Popat, 2009). Going further down the line, when an award is published, one
must expect it to be challenged in court. It could take years for it to pass through that channel.

Introduction of the new Arbitration and Conciliation Act, 1996 has not helped much as the Supreme Court has rolled back the benefit of limited grounds of appeal by suggesting a broader interpretation of the term “Public Policy” which is one of the few grounds on which an award can be sought to be challenged under this new act.

Faced with the above realities, coupled with the usual issue of inadequate infrastructure, the Parliament drastically amended the Code of Civil Procedure, 1908 (CPC) in the year 1999. One of the amendments was by way of introduction of a new provision, Section 89, which gave the courts the power to refer matters to one of the ADR tracks listed therein: Arbitration, Conciliation, Judicial Settlement, LokAdalat and Mediation. A LokAdalat (literally meaning People’s Court) usually comprises of 3 eminent personalities; like retired judges and senior members of the bar, administration or society generally, who are appointed for a particular term.

They attempt conciliation and Judicial Settlement for dealing with disputes referred to them. Section 89, coupled with Order X Rules 1A, 1B, 1C of the CPC and allied laws, affords judiciary the opportunity to offer the parties an array of avenues to resolve their issues in a timely and amicable manner and, in the process, reduce its backlog. Whereas there already exist some provisions for conduct of Arbitration, Conciliation and LokAdalat in different Statutes, the need for a framework to regulate the ADR tracks as a whole and Mediation in particular has been sought to be fulfilled by the Supreme Court. It has done so by providing the final version of the Model Rules of ADR and the Model Rules of Mediation, both framed by the Law Commission of India, in its Orders passed in the case of Salem Bar Association versus Union of India with a direction that all High Courts should adopt these with such modifications as they may consider necessary. The links to the said provisions of the CPC, as also to the Rules of ADR and the Rules of Mediation for the Bombay High Court can be found at their designated website.

The new law, which came into effect in July 2002, was seen to be adopted with differing enthusiasm across the nation. Some States High Courts had already put in place a panel of trained mediators, who were being referred cases for mediation on
a regular basis, and had also adopted the earlier version of the aforesaid Model Rules (recommended in an earlier Order of the Supreme Court in the same case) with or without modifications. Whereas other States High Courts had either only held ‘Awareness Campaigns’ with little or no follows up action or were in the process of providing mediation training and creating a panel of trained mediators. These ADR developments in the respective states depended largely on the inclination of their respective High Court’s Chief Justice towards ADR.

This not only led to uneven introduction of ADR services in the different states but also led to the implementation of the ADR system gaining and losing momentum with the change of guard in each High Court, which on an average one can expect to happen every other year. Now, after the second Order of the Supreme Court in the Salem Bar’s case, it is to be presumed that all High Courts shall be implementing the ADR system by adopting the aforesaid Model Rules in such form as they choose (Popat, 2009). They will be providing mediator’s training to the legal fraternity and such others as they choose, and setting up panels of trained mediators and providing the list to the Judges, lawyers and parties for consideration whilst appointing mediators. On successful completion of the mediation process, they will take the mediated agreements on record and dispose of the cases on the basis thereof.

The Bombay High Court was fortunate to have, at the relevant time, a senior Judge, Justice AjitPrakash Shah, who was thoroughly convinced about the benefit of ADR for the litigants as well as the Courts backlog.

The parties are free to incorporate in their contract throughout the Indian Territory or other countries notably commonwealth countries i.e. erstwhile colonies of United Kingdom, nevertheless, a trader and a customer can agree that these rights do not apply to a particular transaction for the provision of a service or should only apply to a limited extent. Any such exclusion or restriction will however be subject to the provision of the Unfair Contract Terms Act 1977.

Alternative Dispute Resolution (ADR) refers to neutral mechanisms allowing parties to solve their disputes outside of court in a private forum, with the assistance of a qualified neutral intermediary of their choice. ADR can only be applied if all parties agree to submit their dispute to the procedure or if it is mandated by a
competent court. The benefits include time and cost efficiency, flexibility, party control, neutrality, a single procedure, confidentiality and expertise. In their monumental comparative work on civil justice systems, Cappelletti and Garth (1978) point out that the emergence of the right of access to justice as “the most basic human right” was in recognition of the fact that possession of rights without effective mechanisms for their vindication would be meaningless.

The extensive empirical evidence marshalled and analyzed by ICRIER (2008) will hopefully provide a solid basis for policy in this sector. Based on the empirical evidence and analysis that have been extensively peer reviewed, the study makes a number of policy recommendations that have a bearing on both the unorganized and organized segments of the retail sector. The two most important recommendations made by committee are

1) For the government to facilitate the emergence of a “private code of conduct” for organized retailers in their transaction with small suppliers; and
2) Simplification of the licensing and permit regime to promote the expansion of organized retail.

The example of Multinational Corporations like Wal-Mart, which is spearheading the construction of global systems of private law making, will develop the business process not only simple and transparent but at the same time robust and non litigant. This system of private global lawmaking by multinationals is rising in parallel with, less successful attempts by national and international bodies. It is also advocated to develop a system of public law rules to govern the disputes faced by Multinational Companies in their day to day business dealings.

The role played by the Wal-Mart as a facilitator of trade is exemplary and its contribution to the alternate mechanism for effective business deal is appreciable in the absence of any adequate provision provided by the state legislators who are often grappled with litigation beyond the limit of immediate business interest if not the individual life.

The above development of private legislation is confined to resolving the mutual conflict among the different players of supply chain in particular and other
traders in general. The emerging system cannot act fully as a substitute to the old law making systems of political communities. After all it is a prerogative of the legislature to make laws. No effort is made here at acquiring a monopoly power over legislation, monitoring or enforcement. Since the system is porous and significantly functionally time taking.

The efforts put in by the Transnational Corporation (TNC) for better society has yielded a good result. It will not be out of context to give the example of Restriction imposed by the TNC in terms of child labour employment, minimum wages policy and violation of other human rights. It is not a big task which cannot be achieved by the corporate bodies to evolve an Alternative Disputes Settlement mechanism which will act as parallel to the traditional court system based on the spirit of common law and good conscience.

9.4 Contract Types in Farming

The contracts could be of three types;
(i) procurement contracts under which only produce sale and purchase conditions are specified;
(ii) resource provision contracts wherein some of the inputs are supplied by the contracting firm and the 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.

Whereas the first type is generally referred to as marketing contracts, the other two are types of production contracts (Scott, 1984; Welsh, 1997). The relevance and importance of each type varies from product to product and over time, and these types are not mutually exclusive (Hill and Ingersent, 1987; Key and Runsten, 1999). 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, 1994). Also, different types of production contracts allocate production and market risks between the producer and the processor in different ways.
9.5 Contract Usage Complexities

Recent studies in the food industry literature have identified a number of reasons to explain why farmers and processors might enter into different forms of vertical coordination (such as contracting and vertical integration) as opposed to operating on open markets. Thus, for instance, farmers may enter into contracts to reduce price risks, to get access to capital and new technology, and to assure an outlet for their final produce (Knoeber, Rhodes, Barry et al. 1989).

On the other hand, processors may enter into contracts to assure consistent quality and quantity of inputs to run their processing plants efficiently (Hennesey, USDA 1996a). It has also been suggested that processors may integrate backwards into agriculture to internalize the deadweight loss associated with market distortions which are internalized by integration (Henderson, Mitra et al. 1996).

For different reasons, both farmers and farm product processors/distributors may prefer contracts to complete vertical integration. A farmer may prefer a contract which can be terminated at reasonably short notice. Also, contracting gives access to additional sources of capital, and a more certain price by shifting part of the risk of adverse price movement to the buyer (Hill and Ingersent, 1987). Farmers also get an access to new technology and inputs, including credit, through contracts which otherwise may be outside their reach (Glover, 1987; Eaton and Shepherd, 2001). CF is an alternative to corporate farming which may be costly, risky, and difficult to manage and still not viable (Payer, 1980). Thus, for a processor or distributors, contracts are more flexible in the face of market uncertainty. They also make smaller demands on scarce capital resources, and impose less of an additional burden of labour relations, ownership of land, and production activities, on management (Buch-Hansen and Marcussen, 1982; Kirk, 1987). The firm even gets an access to unpaid family labour (White, 1997) and can make use of state funds indirectly, through agricultural production sector, which are directed at farmers by development agencies (Clapp, 1988). Also, food processors can minimize their overhead costs per unit of production by operating their plants at or near full capacity as contracting gives assured and stable raw material supplies from farms. The firm can also project an image of working with local producers as a partner. It may even obtain nationaland
international agency incentives for its activities as developmental projects, instead of corporate farming (Kirk, 1987). Contracts also help improve product quality by directly introducing incentives and penalties as there are problems of adverse selection and moral hazard in any contractual arrangement resulting in underinvestment or shirking by any of the parties (Wolf et al. 2001).

At more macroeconomic level, contracting can help to remove market imperfections in produce, capital (credit), land, labor, information and insurance markets. It can also facilitate better co-ordination of local production activities which often involve initial investment in processing, extension etc. Most importantly, it can help in reducing transaction costs (Grosh, 1994; Key and Runsten, 1999). It has also been used in many situations as a policy step by the state to bring about crop diversification for improving farm incomes and employment (Benziger 1996; Singh, 2000). CF is also seen as a way to reduce costs of cultivation as it can provide access to better inputs and more efficient production methods. The increasing cost of cultivation was the reason for the emergence of CF in Japan and Spain during the 1950s (Asano-Tamanoi, 1988) and in the Indian Punjab during the early 1990s (Singh, 2000).

From an institutional economics perspective, the logic for CF could also come from the creation of positive externalities like employment, market development or infrastructure, if agribusiness firms create them better than the open market or the state (Key and Runsten, 1999). CF figures as an institutional arrangement/ innovation for agricultural development in the developing world (Glover, 1987) in the fields of inputs, product exchange, and product upgrading, the last referring to research and innovations (Christensen, 1992). Due to the efficiency (co-ordination and quality control in a vertical system) and equity (smallholder inclusion) benefits of this hybrid system, it has been promoted aggressively in the developing world by various agencies (Glover, 1987).

9.6 Contract Farming for Small producers

Generally, contracting agencies especially private, tend to prefer large farmers for CF because of their capacity to produce and supply better quality crops as they use efficient and business-oriented farming methods and possess various facilities like transport, storage, etc. They also supply large volumes of produce which reduces the
cost of collection for the firm. Besides, they have capacity to bear risk in case of crop failure (Wilson, 1986; Winson, 1990; Burch and Pritchard, 1996; Fulton and Clark, 1996; Key and Runsten, 1999). On the other hand, small farmers are picked up by firms for contracts only when the area is dominated by them or there is government directive to do so. Many times, they are also 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). Firms can also benefit from lower cost production on small farms as these farmers have access to cheaper family labour, and being residual claimants of their labour, they work more conscientiously than hired labor (Key and Runsten, 1999). In Canada, small tomato growers were preferred as the crop required hand-picking which only small farmers do, unlike their larger counterparts, especially when weather limits the use of mechanical harvesters (Winson, 1990). Similarly, in India, gherkin CF is carried out by small and marginal farmers as the crop requires plenty of labour inputs which these farming families can provide from within (Dev and Rao, 2005). In fact, some of the agencies even use large growers, rural elite, and local small processors as subcontractors to get procured from the small growers (Kirk, 1987). The seed companies in India use small companies as subcontractors to procure seeds produced under contracts (Shiva and Crompton, 1998) and have large farmers and agricultural input or output traders as seed production organizers or sub-organizers. Also, working with many small farmers helps spread risk of supply failure as compared to working with a few large farmers.

In fact, the eligibility criteria for participation in CF projects/schemes like irrigated land, suitable land, land near main road, literacy level of the farmer are themselves discriminatory in terms of who can be a contract grower. In fact, in CF everywhere, private agribusiness firms have less interest and ability to deal with small scale farmers on an individual basis (Hazell, 2005). This essentially means that contracting companies do not specifically encourage the participation of those who need to be helped to participate as risk preference and innovativeness require not just attitude but also resources and risk taking capability to undertake risky crops and ventures (Glover, 1987). The aspects of contracting which contribute to CF excluding small producers are: enforcement of contracts, high transaction costs, quality.
standards, business attitudes and ethics like non/ delayed/ reduced payment and high rate of product rejection, and weak bargaining power of the small growers (Kirsten and Sartorius, 2002).

9.7 Status and Performance of CF in India

CF has various models/ variants being practiced in India at present. This ranges from direct bi-partite contracts to tri - and multi-partite agreements wherein other than farmers and processors/ marketers, banks or facilitators/ organizers of CF get involved. They even include government agencies, local development agencies/ NGOs, and local middlemen and franchisees.

Performance of CF can be judged by the farmer’s satisfaction with contracts. The farmer’s satisfaction can be measured by the growers’ interest in the contract system, number of farmers under the arrangement __ growing or dwindling, contract compliance by the two parties, and the level and frequency of income and its distribution effects across classes of farmers (CDC, 1989). More specifically, it is captured through profitability of the crop, efficiency of payments and input supply, market assurance for the produce, and farmer’s participation in crucial decisions relating to contract production. Beyond immediate performance in terms of parameters of a contract, it can also be judged from the extent of inclusion or exclusion of small producers in a given CF program or project. Besides the resources and technology which determine CF performance, it is the relationship among state, companies, and farmers, which shapes formal and informal institutions and gets mediated by them, that matters (Ornberg, 2003).

Breach of contracts by farmers as well as by firms has been reported (Bhalla and Singh, 1996; Singh 2002; Haque, 2003). But CF in Gherkin and iceberg lettuce crops was also smooth as there was no local market or thin market for the crop, there was flexibility in contracts due to the short term nature of the crop, and farmers maintained alternative sources of income (Singh and Asokan, 2005; Khairnar and Yeleti, 2005).
9.8 **Hi-Tech Farming through CF**

A few examples are noteworthy to visualize the resulting effect of CF. The contract farmers are highly benefited by way of receiving elite seeds of onion which is supplied at a subsidized rate. The advance amount (50 percent of the total seed cost) is usually deposited by the contract farmer at the time of purchase and the balance is recovered from the sales proceeds of the produce at harvest of onion. Farmers are exposed to latest cultivation methods. The emerging technologies comprising of total package of timely agronomic practices are transferred to farmers. Record keeping, efficient use of farm resources, improved methods of irrigation through drip and/or sprinklers, fertigation, a knowledge of the importance of quality, the characteristics and demands of processing industry are some of the skills exposed to contract farmers. A booklet in Marathi/ Hindi on hi-tech precision farming of onion is given to each contracted farmer free of cost. Being a micro irrigation system manufacturing company over the years, it has managed to bring more than 80 percent contract onion farming under MIS, ensuring higher productivity and better quality of the produce.

9.8.1 **Double Price Formula**

In the above example, the farmer, by following the recommended package of cultivation practices, gets increased productivity and higher income. No price risk, whatsoever is involved as the company assures minimum guaranteed price of Rs.3/ kg on delivery at the factory. However, on the date of purchase if the market price is more than Rs.3/ kg, the company pays the farmer the prevailing market rate. If the market price falls below Rs.3/ kg, the contract grower is paid the Minimum Guaranteed Price (MGP). Thus the contract follows what is known as double price formula. The group believes that this is the only way it can work. There is no other way the farmer's behavioral response can be predicted or policed. An increased farm yield, coupled with prevailing market price or MGP, earns him increased net revenue. Absence of middlemen, brokerage charges etc., is a welcome plus to his earnings. Moreover, premium produce of organic onions are purchased by the company at 15 percent extra prices. The company also provides jute bags for packaging the onions for dispatch to the factory.
9.8.2 Linking with Banks

One of the critical factors for the company's success in contract farming is the involvement of lead nationalized banks such as State Bank of India, Union Bank of India etc. These banks offer, for certain contracts, crop loan for cultivation and term loan for purchase of capital equipments like drip/ sprinkler system. The company assumes the responsibility as facilitator, liaising between the farmers and the banks and pays back the dues directly to the bank by deducting from the sales proceeds of the onions, sold to the company. The farmers are encouraged to install micro irrigation along with fustigation (Fustigation is the application of fertilizers, soil amendments, or other water soluble products through an irrigation system) system availing the term loan from State or Union Bank of India up to Rs.25000 per acre. The company can enter into a Memorandum of Understanding with these banks wherein the payback period is around 4-5 years. The contracted farmers also avail crop loan to meet the cost of cultivation at Rs.8500 per acre from Union Bank of India, and at Rs.10,000 per acre from State Bank of India. The banker's dues are deducted by the company from the sale proceeds and the balance paid to farmers. Thus the banker gets far more comfort and the farmers get the credit delivered to his door steps. Micro Irrigation System being hi-tech input, productivity is enhanced significantly. The above figures have been drawn from a specific CF example and may vary with crop/bank/situation.

9.8.3 Quality Monitoring

One of the major advantages to the company through contract farming is a close monitoring of product quality. As a result, production and quality through this system is more reliable than open-market purchases and the company faces less risk due to losses resulting out of pest and disease attack. Since the farmers are well-versed with hi-tech cultivation, with proper harvesting and curing practices, the produce supplied is of superior quality and ideal for processing. This clearly spells out a 'win-win' situation for both the farmer as well as the company. It has therefore been possible to perpetually obtain the desired quality and quantity of produce from nearby contract farms under stringent supervision and control.
9.9 Legal impediments for Contract farming

The Model APMR Act, 2003 of the Government of India has recommended the compulsory registration of contract farming with Market Committee. Sponsor is commended to register himself with the Sub Divisional Officer or with an officer prescribed by law. The National Commission on Farmers, however, has given its recommendations not to involve the Market Committee as a party to contract farming. Accordingly, Market Committee would not be registration authority for Contract Farming and the Contract Farming Sponsor shall get the Contract Farming agreement recorded with the Sub-Divisional Magistrate, who, in turn shall ask for such documents as required to verify the credentials of the sponsoring company. Absence of a proper legal framework is a major impediment in popularizing contract farming system in the country. Under the present system, the Contract Act is the only law for contract farming, but the provisions of the Contract Act do not cater to the specific requirements of contract farming in a suitable manner. Besides the costs, procedural delay and the distance from the Courts work as disincentive to the farmer to invoke the Civil Courts jurisdiction when the need arises. The different types of possible disputes arising out of contract farming can be attributed to the reasons like refusal to receive delivery of the commissioned goods, delay in payment beyond agreed period, discounting of payment, returning the commissioned goods without any good reason, forced price reduction, compulsory purchase by subcontractors of parent firm’s products, and forcing subcontractors to pay in advance for materials supplied by the parent firm etc.

9.10 Disputes in Contract Farming

Further Birthal(2007) in his paper, which is mainly based on Eaton and Shepherd (2001) and Arthur B. da Silva (2005), has concluded that Contract farming is a partnership between agribusiness/ marketing firms and farmers, and has both advantages and disadvantages to both the parties.

Changing relative incomes of members of a community is likely to cause social tensions in the agricultural community, as people discover that previously secure positions in social hierarchies are under threat. The Indian village community is dived on the basis of cast, creed and other social categories, which perpetuate the
interest of the dominant community. A losing group which is generally marginal farmer may be forced to sell more labour, possibly on a casual or daily basis, leaving them in different social and economic circumstances than previously. Also, this poorer group may previously have benefited from traditional reciprocity arrangements and find themselves disadvantaged as traditional values diminish in importance in the face of the strong cash culture that goes with contracting (Clapp, 1988; Wilson, 1994).

### 9.11 NGOs in Contract Farming

Role played by Non Governmental Organizations (NGOs) for monitoring of Contract Farming can also facilitate contracting by small holders. Glover and Kusterer (1990) found interaction of an NGO with a Central American farmers’ group contracting for vegetables had a positive effect on farmers’ performance and that farmers in neighboring regions working with similar contracts but no NGO were less successful in terms of persistence with the contract. The NGO provided agronomic advice to the smallholders and evaluated advice given to growers by the agribusiness firm over a number of years. In Mexico, Asesoria y ServiciosIntegradosAgropecuarios (ASIA) acts as an intermediary between smallholders and agribusiness firms in negotiating contracts and facilitating arrangements in contract flower production. Their role includes contract evaluation, discussion with smallholders, and liaison with the contractor, technical assistance and helping with purchases of farm inputs. The NGO also provides links to credit sources and is actively involved in making and receiving payments (Rello & Morales, 2002). In his African study, Porter and Phillips-Howard (1997) also argue for the positive effects of NGOs on contract performance as do Eaton and Shepherd (2001) in their general review of contract farming.

### 9.12 Government in Facilitation of Contract Farming

There are many ways whereby government can help the successful completions of Contract farming but for policy sake there are two types of facilitating policies that are relevant to contract farming. These are:

(i) adjusting the regulatory regime to reduce transaction costs for participants in contracts, and

(ii) government playing an enabling role to encourage contract farming.
Regulatory adjustments to create a desirable policy environment for contracting include reducing paper work for exporters, reducing certain import and export taxes, removing import restrictions, implementing food-safety standards, replacing crop production taxes with land taxes and deregulating prices in food markets. Removal of specific regulations can directly facilitate contracting. For example, removal of import restrictions on a specific variety of seed-potato by the Philippine Government led directly to contracts between frozen French-fries processors and smallholders (Eaton and Shepherd, 2001).

The enabling role of government in contract farming may include training, arbitrating disputes, undertaking research and provision of extension services. Training programs for smallholders in literacy, accounting and cash management can reduce miscommunication in contracts (Glover, 1990). Most developing countries’ governments undertake research on agricultural production and often on food processing and marketing. Opportunities may exist for increasing the productivity of resources used in contract production of HYV (High Yielding Variety) crops by building co-operative relationships with agribusiness firms that result in sharing of information about research priorities and issues. With extension, the tendency is for agribusiness firms to undertake their own or outsource it to ensure quality standards are met and contracts stay on track. However, government extension officers could also play a role in advising farmers on production techniques and contracting opportunities and by facilitating contact between firms and interested smallholders.

9.13 Conclusions

After the economic liberalization India has increased its involvement into the affairs of World Trade Organization. This has also intensified and brought to fore the role of the agribusiness firms who are entering into contract with primary producers and farmers for supplying raw materials. This awareness on the part of small and big agro firms provides a broader picture of effects of international trade expansion in food products on the economic and social environments in India as well as in developing countries. This study has shown a market liberalization of the changing pattern of agricultural production in terms of on-farm crop and livestock mixes, increasing total production in physical and value terms and changing the types of food products entering international markets. Further the study also shows that traditional
values and habits in agricultural products are undergoing a change and the old deals are being replaced by transactions that increasingly reflect a ‘cash culture’.

How much the above developments benefit the farming community is disputed on one or the other ground. Many argue against the benefits of contract farming saying that since the primary producers or the farmers lack the bargaining capacity to negotiate the contract, they often end up on the losing side by entering into contracts that are detrimental to their interests. 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 farmers.

There are pertinent findings which suggest that if contract farming is rooted in appropriate policy, statutory and institutional legal framework, the CF has tremendous potential to help the agricultural community in general and the small and marginal farmers in particular.

Several studies have proved that for successful contract farming, the nature and the practices of the ‘contract’ are central to the issue of contract farming. The important aspects are not only the drafting and transparency in the contract but also its’ capacity to protect the benefits of the primary producers and farmers.

There is a need to have a comprehensive statutory protection from ill effects of contract farming for the farmers. But the practice of contract framing alone can also not be overemphasized and advocated vehemently. The agricultural co-operatives, the Non Governmental Organizations (NGOs) and the civil societies should also be given chance and the legal and regulatory system should enable them to play a prominent role in protecting the interests of farmers in contract farming.

The enforcement of agricultural contracts is an important pre-condition for efficient exchange and investments in economic activities in general and in agro-food in particular. When a breach of contract happens, one or both the parties might wish to enforce the agreement on its terms.

In developing countries enforcement institutions are often weak or absent. India is not an exception to this rule. Government interventions to address such a shortcoming are needed as a pre-condition for the development of a favourable climate for business investments. Effective enforcement mechanism is important for successful Contract Farming. Mediation, reconciliation, arbitration etc. should be
made to exhaust first before resorting to civil court for dispute resolution. A flexible contract may allow renegotiations and thus enable parties to adjust the contract to changes in the environment.

References


