Locked into Business

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Capitalism we are often told is a system in which markets mediate a set of arms-length relationships. Combine that with competition and we are promised the best in terms of cost, price, quality and availability. But the votaries of unfettered capitalism often challenge this textbook-perfect picture themselves. One example is their advocacy of contract farming: a system in which agricultural production is carried out through an agreement between farmers and buyers, that specifies a combination of features such as price, quality, volumes to be supplied and date of delivery, which farmers as suppliers are expected to adhere to, and in response to which buyers are expected to redeem their pledge to acquire supplies at the pre-specified price. A Harvard University biologist (R. C. Lewontin, Monthly Review, July-August 1998) has characterised this system as practised in the United States as involving "a vertical integration of farm production in such a way that the purchasers of farm outputs take control of the entire production process. This vertical integration is made possible by 1) a technical linking of the inputs and outputs, 2) the dual function of a single capital enterprise as both the monopsonist (near monopoly) purchaser of outputs and the provider of critical inputs, and 3) a contract mechanism that links farmer into the loop of inputs and outputs." In India, the government too, as part of its liberalisation drive, has been encouraging a turn to this system and made legislative changes to facilitate its proliferation.

On the surface the system seems to lock both farmers and buyers into what is an equal relationship. But, besides not being arms-length as a result, the relationship is most often unequal, with buyers being large corporations looking for guaranteed supplies at pre-specified prices, and suppliers being competing farmers who are economically weaker partners in the arrangement. In fact, large buyers often subordinate farmers within the relationship by providing them with inputs and/or credit, giving the former substantial leverage vis-à-vis the latter. Thus, instances of contract farming in India have involved companies such as Pepsi (in potato and groundnut, among other crops), Unilever (tomato and tea), ITC (tobacco and oilseeds) and Cargill (seeds). It is true that large foreign and domestic conglomerates such as these enter into contracts with relatively larger farmers who are better suited to meeting quality and volume requirements. Yet there are huge differences in relative economic weight between producers and buyers that are bound to influence the nature of the relationship.

Yet advocates of contract farming tend to present the relationship as a win-win solution for both sides. While buyers are assured of supplies and can intervene in production to ensure quality, it is argued, empirical studies show that farmers who operate under the contract farming system obtain better and more predictable prices than their counterparts outside the system. There is, however, the potential for and some evidence of the dangers inherent in the unequal system. While farmers are assured of price, volumes sold would depend on the portion of the harvest identified by the buyer as of appropriate quality. This quality angle could be used by powerful buyers to renege on volumes promised to be acquired in the contract in times when market demand is low or when harvest fluctuations result in buyers being able to acquire much cheaper supplies from farmers outside the system. Moreover, in years of lean demand, buyers can delay payments as happens very often in the relationship between ancillary suppliers and large buyer firms in the industrial sector. That is, if circumstances arise when buyers tied into contracts find that they could lose out if they stick to their commitments, the unequal relationship can and has resulted in the buyers reneging on their commitments.

Even when contract conditions are not implicitly violated, the risk associated with contract farming could be greater if meeting the quality and volume demands of the buyer requires substantial investment on the part of farmers, who undertake that investment based on credit provided or organised by buyers. Shortfalls in production resulting from weather fluctuations, pest attacks and the like would under the new farming conditions result in much higher losses than would have otherwise been the case, hurting farmers and burdening them with debt.

If farmers are still willing to enter into such arrangements, it is because of the instability and uncertainty inherent in peasant-based, fragmented and largely rain-dependent agriculture. This periodically challenges the viability of crop production and the agricultural sector fails to deliver to the non-agricultural sector its requirement of a marketable surplus of agricultural supplies, especially food. That possibility forces the state to intervene to stabilise agriculture.

Thus, it was the agrarian crisis of the mid-1960s that forced the Indian government to launch on the Green Revolution strategy, under which the 'package' of support provided included not just hybrid varieties, fertilisers, pesticides and improved irrigation, but also extension services, credit and remunerative floor prices at which output was procured. Within that framework, the government was a kind of 'contractor', offering a range of services, including technical services (backed up with agricultural universities across the country) and promising to acquire, if necessary, supplies at pre-specified, cost-plus prices. In return, it hoped to procure the supplies needed to ensure food security for the country's population.

Overtime, a government unwilling to mobilise the resources required to finance this comprehensive package, has let the extension services system collapse and reneged on its promise to procure and distribute enough to ensure universal food access at affordable prices. Liberalisation and deregulation are in part a consequence of this failure. Not surprisingly, the 'promotion' of contract farming through deregulation has been partly justified on the grounds that it is way of introducing better and more modern farming practices into a slowly growing agricultural sector affected by dwindling productivity in many regions. Large commercial buyers, it is argued, would provide the credit, the technical services and the remunerative prices that the state had committed to provide, but has not been adequately successful in ensuring. Whether this would indeed occur needs to be tested, but there are strong reasons to believe that this would not be delivered by profit-maximising private players, damaging both contracting farmers and the food security system.

The possibility that direct marketing and contractual relationships between vulnerable farmers and large buyers could be damaging for the farmer was what resulted in the regulation of markets through the Agricultural Produce Marketing Committees (APMCs) that were to be established by the state through the enactments of state level APMC Acts. No trade in designated agricultural produce in excess of a specified quantity can occur outside markets regulated by these Acts. The idea behind the creation of the APMCs was not only that of providing better marketing facilities, but of establishing regulated markets in which orderly and transparent trading conditions permit price discovery by farmers who might otherwise lose as a result of unequal buyer-seller relationships.

More recently, the central government has framed a ‘model’ amended version of the APMC Act, which includes provisions for direct marketing and purchase of agriculture produce from farmers, contract farming and setting up of markets by the private sector. Most states have now adopted versions of this model Act, paving the way for an increase in the contract farming practice. The positive feature here is that contract-farming agreements have to be registered, allowing in principle for monitoring and systems of dispute settlement. But, inasmuch as the relationship between the contracting parties is unequal, the terms of the contract are bound to benefit buyers and complaints are unlikely to be registered whenever they arise. In the event, after the first flush in which contract terms and contracting behaviour would be adjusted to attract farmers into relationships with large buyers, economic instability and even deterioration could be the fate of those entering the practice.

The question remains as to why large commercial operators dependent on agricultural supplies would choose to enter into such relationships. One reason is that peasant agriculture has been resistant, even if not immune, to the take over of its operations by large private capital. As Lewontin (quoted above) notes, there are a number of reasons for this. First, the acquisition of large tracts of contiguous farmland is not easy and often unattractive to capital. “The labor process on very large farms is hard to control because farming operations are spatially extensive.” Economies of scale are hard to achieve beyond what has already been realized by medium-sized farms. And, “risks from external natural events like weather, new diseases, and pests are hard to control”.

It would be best if risks can reside with farmers but control over production and marketing can be acquired by capital. This is what the system of contract farming seeks to do. It does so by enticing farmers into using equipment and inputs that deliver revenues and profits to external producers and produce and deliver outputs that external agents can distribute or process for profit. Since this penetration of external capital into agricultural production is driven by profit, it is to be expected that the agribusiness value chain is modified in ways that leave a smaller share of revenues and value added with farmers. At the end of the twentieth century in the US, it was estimated that around 10 per cent of every dollar consumers paid for food went to the farmer, with 25 per cent accruing to input suppliers and the remaining 65 per cent to those engaged in the transportation, processing and marketing of food output. If that is the intent of contract farming, expecting it to benefit farmers in the long run would be to miss the motivation for the transition to this form of organising agricultural production.

Moreover, the experience in countries other than India suggests that the spread of contract farming has implications not just for those entering into contracting arrangements but the agricultural sector in general. As noted earlier, given the volumes, farming practices and standards demanded by contracting buyers, agreements are normally entered into with larger farmers who have the wherewithal to meet those demands. Where successful, this excludes smaller producers from markets and encourages acquisition of more land by those who have established successful relationships, leading to intensified peasant differentiation and the reduction of large numbers of poor and marginal peasants to the status of agricultural workers. This too then helps bring the whole of agriculture under the sway of big capital.

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