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The government's role in contract farming

The bureaucratic hurdles instituted in the form of a new regulator to oversee contract enforcement will be counterproductive

The government has been making efforts to integrate farmers with agro-industries to ensure that they get better prices for their produce. This is why contract farming has come to be seen as a panacea. Contract farming refers to an agreement between farmers and marketing firms for the production and supply of agricultural products under forward agreements, frequently at predetermined prices. The contract between farmers and buyers insulates farmers from price risk, helps them develop new skills, and opens new markets. Nevertheless, contract farming suffers from market failures.

Monopsony: Typically, contract firms enter into an agreement with farmers to grow differentiated crops. This turns the firm into a sole buyer and farmers into price-takers. Contracting firms can exploit this situation to their advantage by offering lower prices to farmers.

Information asymmetry: Contracting firms do not have complete information on productivity and land quality. This can lead to a situation where farmers produce below-quality crops. On the other hand, farmers sometimes do not understand contract specifications like the quantity and quality to be produced, or the effect of price change. These market failures lead to suboptimal outcomes. Buyers may penalize farmers. Similarly, farmers may indulge in side-selling or leak the technology provided by the contracting firm. Therefore, the question is: Is there a role for the government to intervene in the contract farming market, and what should it do to address market failures?

In India, contract farming is regulated under the Indian Contract Act, 1872. The Act has many general provisions that are relevant to contract farming, including the formation of contracts, obligations of parties, and consequences in case of breach of contract. In addition, the model APMC (agricultural produce market committee) Act, 2003 provides specific provisions for contract farming, like compulsory registration of contract farming sponsors and dispute settlement.

The department of agriculture and farmers welfare has now come out with a draft model contract farming Act, 2018. It intends to establish a win-win framework for both farmers and sponsors. Instead, some of the clauses do the opposite.

The model contract farming Act proposes a state-level agency, the Contract Farming (Development and Facilitation) Authority, which would put contract farming outside the ambit of the APMC. The model Act requires the sponsor and the farmers to register the contracts with a registering and agreement recording committee. Registration imposes additional procedures and costs on the parties, and small and medium farmers cannot easily afford these costs. The Act also proposes price protection for farmers by determining a pre-agreed price. This will be counterproductive. How

would the sponsors incentivise the farmers to perform if the state provides farmers a perverse incentive to not perform? The entire premise of the model contract Act seems to be aimed at creating a legal infrastructure to ensure that both parties honour the contract. This approach is flawed. The government should correct for problems that lead to contract failures and not put both parties into an "inconvenient marriage". Some measures could include:

Foster more competition: The government needs to create market-based incentives for both farmers and buyers. It should improve farmers' connectivity to spot markets and *mandis* across the country. E-NAM (National Agricultural Market) is a great initiative in that direction. This would encourage contracting sponsors to raise their bids and compete to enrol farmers to secure input supplies. The competition amongst sponsors would also incentivise them to offer better terms and services to farmers.

Provide public goods: The government should maintain an information repository of farmers and contracting firms. The repository can provide details about farmers or farmer producer organizations with regard to land availability, default rate, and performance standards. Similarly, details of sponsors can include services provided, requirements of crops, and the default rate. This will help farmers and sponsors to evaluate each other prior to engaging in contracts. Also, the government can facilitate the establishment and enforcement of standards for crops. This will set clearer expectations regarding the contracted crop.

Encourage softer means for enforcement: Incorporating risk-sharing mechanisms in contracts, incentive schemes, repeated contracting and renegotiation options, and simplified and transparent contract terms would help in contract enforcement. The government can educate farmers and make them more aware about contract farming and model contracts.

In conclusion, it may be said that the model Act makes a good move in the direction of promoting contract farming. However, the bureaucratic hurdles instituted in the form of a new regulator to oversee contract enforcement will be counterproductive. The government should focus on providing an enabling environment by fostering competition and bridging information asymmetries between farmers and buyers. Unless this ecosystem is provided, there is very little reason to believe that the new model Act can promote contract farming.

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