

**Notional Contracts: The Moral Economy of Contract Farming
Arrangements in India**

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Abstract

This study examines the moral economy of firm-farmer contracts in contract farming schemes in India, bringing together data from field surveys, conducted between 2007 and 2010, of 42 agribusinesses and 484 contract farmers from multiple commodity sectors. The central argument of this paper is that contract farming relationships in India are seen more as relationships and less as contracts, with formal enforcement mechanisms playing only a peripheral role in maintaining and supporting transactions. This is related only in part to the costs and inefficacy of formal enforcement mechanisms. Both firms and farmers prefer to operate outside the prescribed legal-institutional structure whenever these structures are perceived to undermine the handshake ethic. The findings indicate that state policies that presume legal institutional development to be necessary and sufficient for promoting agribusiness interaction with farmers might be misplaced if not merely ineffective.

Keywords: contract farming, private enforcement, moral economy, legal institutions, agriculture

JEL Code: K49, L14

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INTRODUCTION

The years since the 1990s have seen a dramatic change in the institutional landscape of Indian agriculture. Against a background of persistent agrarian distress, a collapse of the public extension system and heavy state intervention through marketing controls that frustrate the entry of new private players such as agro-food retailers and processors, the government has attempted to reconfigure institutions in the agricultural to create spaces for the private sector within agriculture. Contract farming began to feature prominently in this effort.¹

However, a chief problem that has frustrated the uptake and spread of contract farming schemes in India stems from enforcement issues (Asokan and Singh, 2003; Gulati et al., 2008; Jain, 2008). Weak public institutions for enforcement give latitude to both farmers and firms to renege on the contract and parties inevitably resort to various forms self-regulation and other private means of enforcement to maintain transactional relationships.

It is common, therefore, to see policy discussions urging establishment of legal and institutional mechanisms for enforcing contracts between agribusiness and farmer. These prescriptions are predicated on the notion that developing a legal framework for contracting and enforcement is desirable, even necessary, to enable expansion of contract farming relationships and would provide incentives for both farmer and firm to enter into formal, legally valid agreements.

This paper interrogates the prescriptive logic that sees legislative mechanisms as the main vehicle for resolving contractual disputes, arguing, as others before have done in other contexts, that legislative mechanisms might be neither necessary nor sufficient for maintaining agribusiness-farmer relationships. The central argument of this paper is that this view is at odds with the empirical agrarian context in India, where agents, both farmers and firms, express a reluctance to develop formal contracts with legally binding obligations, preferring to continue with transactions outside the prescribed legal-institutional structure. While exploring the many reasons for this reluctance, this study suggests that the presumed efficacy of legal institutional development neglects the more complicated role that legal systems play in

¹Contract farming is described broadly as an institutional arrangement between farmers and businesses to produce and transact agricultural commodities at predetermined prices and conditions, via oral or written contracts. In several states in India, where agricultural produce was traded only in regulated markets and licensed traders, contract farming was feasible only for specific sectors such as plantation crops, dairy and sugarcane.

the midst of other, ‘informal’, regimes of enforcement in Indian agribusiness, as it does the particular relevance of socially-embedded relationships for contractual performance.

This paper offers a broad analysis of contract and enforcement in select contract farming schemes in India, observing that firm-farmer contracts are often only notional supported by a moral economy which offers scope for transgressions and breach, within limits. The paper does this by bringing together data from surveys, conducted between 2007 and 2010, of 42 agribusinesses (Agribusiness Survey) across India and 824 farmers (Farmer Survey) from multiple commodity sectors in the south Indian state of Tamil Nadu.²

THE PRESCRIPTION AND ITS LOGIC

Recent years have seen enormous emphasis placed on developing strong and effective legislative frameworks for contract enforcement and dispute resolution in India with a view to creating favorable conditions for the growth of contract farming. These recommendations have taken many forms.

In 2003, the Government of India proposed a Model Act (The State Agricultural Produce Marketing Development and Regulation Act), which outlined a framework for contract farming operations that would safeguard the interests of both firms and farmers. States were urged to adopt this legal framework to enable rapid growth of contract farming.³ The Model Act provided for registration of all contracts and a thirty-day window for resolving contractual disputes. The World Bank (2005) too believes that the “government can foster the development of contractual arrangements by facilitating the creation of producer organizations, legislating an appropriate contract law and enforcing it effectively” (emphasis added). The US-India Knowledge Initiative (KIA)⁴, a bilateral program in agriculture, suggests that “legal mechanisms for contracts and alternative mechanisms for regulating contracts would be evolved based on the American experience”(Kuruganti, 2008). There have also been calls for regulating contract farming so that firm-farm relationships are more “equitable and farmer-centric” than at present.⁵ This is a cross-section of opinion with diverse ideological content that emphasizes legislation to varying degrees as a way to foster contract farming arrangements, under the implicit assumption that legislation would in fact encourage actors to enter the legal fold to transact while protecting poor farmers.

²The Farmer Survey was conducted in two phases. Phase 1 (2008-09) included gherkins and cotton contracting schemes and Phase 2 (2009-10) included broiler, papaya, marigold and gherkins.

³ In India, agriculture is a State subject, so the legal provisions regarding contract farming would be State-level laws rather than a federal-level or national law.

⁴ The U.S.-India Knowledge Initiative on Agricultural Education, Teaching, Research, Service, and Commercial Linkages (AKI) was initiated on July 18, 2005, with the United States, with secured funding of \$8 million in fiscal year 2006 and a total of \$24 million pledged through 2008. (<http://www.fas.usda.gov/icd/india/knowlinit/factsheet.asp>, accessed October 23, 2008)

⁵ The National Commission on Farmers (Third Report, 2006), for instance, advocates a Code of Conduct for all agribusinesses engaged in contract farming, that would pay special attention to clauses dealing with quality standards, withdrawal conditions, pricing standards, paying arrangements, acts of God clauses and arbitration mechanism.

Interestingly though, even where such mechanisms have been introduced in credible ways, they have not met with success. In Maharashtra, for instance, four months after an ‘appropriate law’ with a blueprint for enforcement was put in place, the officer overseeing proposals had failed to receive even a single proposal.⁶ “Earlier, contracts between companies and farmers were not governed by a dedicated Act. Now, we have the Act which stipulates rules that have to be followed. But contracts are not being signed under this Act.” (Ghadyalpatil, 2008) This is not unique. In states where the Model Contract Farming Law has been adapted, the response of firms to undertake contract farming schemes within this framework has not been encouraging (Ghadyalpatil, 2008; Gulati et al., 2008).

Why is there a disconnect between the perceived merits of legislative frameworks and actual practice? What explains the reluctance of agribusinesses in India to respond to state initiatives to promote formal contract farming? These questions invite us to examine the more fundamental issue of the role of ‘formal’ or third party enforcement in supporting economic exchange.

It has long been recognized within economics that markets need to be supported by institutions for economic governance. Institutional creation and maintenance was a role left to the state, by even the most libertarian of economists, like Friedman (1962). Traditional economics typically veered to the view that the framework of law is a necessary condition for the market to succeed, for, in its absence, unbridled opportunistic behavior could lead to dysfunctional societal systems. Another view, derived from Coase (1937), went further to suggest that such a legal framework might even be a sufficient condition, so that as long as property rights are well-defined, in the absence of transactions costs, voluntary economic exchange would follow as a matter of course and produce optimal welfare outcomes.⁷

Correspondingly, in the development literature, early views associated ‘development’ with a move from relation-based transactions to rule-based transactions, or from custom to contract and informality to formality.⁸

This strand is evident in more recent works, like those of de Soto (2000) and Acemoglu et al. (2005), who see well-defined property rights as fundamental institutional preconditions for ‘development’ (Harriss-White, 2008). To the extent that contracts assign relative property rights and given that institutions that enforce these contracts protect these rights (Furubotn and Richter, 2005), ‘development’ itself is associated with the establishment of such enabling institutional frameworks that accommodate

⁶ The credibility of these interventions is important. In a transition economy, new initiatives might take some time to take root and intended beneficiaries might lack faith in the institutions that oversee these initiatives. While this typically contributes to an initiative’s lack of success, in the example cited in the text, the firms articulate a different concern, which is central to the preoccupations of this paper. This is taken up specifically in a later section.

⁷ Admittedly, in the context of Indian agricultural relations, this Coasian view was never admitted seriously into discussions, given the high transactions costs.

⁸ As Harriss-White (2008) points out, each of the classical political economists, Smith, Marx, Weber, Veblen, Schumpeter and others, expected archaic forms of exchange to be replaced by markets, the struggles of wage labor against exploitation and illusion, and the rationality of state bureaucracy and planning, and by the discipline of machines, technology and education, respectively.

formal contracts. Prescriptions that emphasize the installation of legal mechanisms to enable contract farming are aligned closely with this tradition of legal centralism and a positivist-formalist understanding of contracts.⁹ They privilege the view of a rational state that oversees economic exchange in a non-partisan and costless manner. These prescriptions thus retain validity insofar as the non-trivial assumptions that inform these theoretical viewpoints hold in reality. As I argue below, this is far from self-evident. In short, there is often a schism between institution design and use.

ENFORCEMENT AS THEORETICAL SUBJECT

The challenge to the above positivist-formalist view comes from various quarters. Among these is the natural and intuitive critique that transactions costs do exist and influence forms of economic governance structures.¹⁰ Furthermore, the state (or judiciary) is itself socially regulated, far from being an informed, non-partisan, omniscient arbiter.

The presence of transactions costs then implies a search for an economic governance structure (in this case, an enforcement mechanism) that minimizes these costs (Williamson, 1996). A number of enforcement mechanisms outside of the state are, in fact, available to parties engaged in economic exchange and governance is not always carried out by government. Taxonomies of enforcement mechanisms classify these modes of economic governance either as private ordering versus public ordering depending on the role of the state, or as first, second or third party enforcement (Dixit, 2004). First party enforcement operates at the level of the individual. Norms of behavior are internalized so that reward for compliance or punishment for deviation takes the form of moral or social imperatives (Dixit, 2004). Platteau (1994a,b) elaborates for instance on the role of ‘generalized morality’, while Fafchamps (2004) discusses incentives to comply driven by shame and guilt.¹¹

Second party enforcement refers to bilateral and multilateral links with other members of the same community or network, for relationship-building and punishment. Bilateral relationships recall the notion of a repeated game setting between two players and of the Folk Theorem result, where short term gains from defecting are overshadowed by long-term gains from cooperation (Kandori, 1992). In the case of multilateral enforcement, the group collectively sanctions deviant behavior on behalf of the aggrieved player. Greif (1993) studies Maghribi trader coalitions that supported the operation of a reputation

⁹ The core of legal centralism presumes contractual conflicts are costlessly decided by well-informed courts in an objective, legalistic way. See Griffiths (1986) for a detailed discussion.

¹⁰ The transactions costs economics view or the NIE view is thus not the only critique. Economic exchange represents a complicated subject where law, economics and sociology intersect. For instance, sociologists fault the legal-centric view for being “under-socialized” in ignoring the social embeddedness of transactions (Granovetter, 1985) and the role of social networks and norms. In this study, I choose to retain a somewhat narrow focus, adopting the NIE line of critique.

¹¹ Kolm (2000) makes the distinction between moral and social imperatives. Guilt for violation is moral but shame is social.

mechanism to tackle agents' commitment problem, and Genoese traders' use of merchant guilds. Milgrom et al. (1990) look at the role of merchant courts in the Champagne fairs of medieval Europe as institutions for enforcement. Establishment of credit reporting bureaus is a contemporary example (de Janvry et al., 2010).

Third party enforcement is a broad term that refers to an outsider-arbiter, who is not directly involved in the transaction. In game-theoretic terms, this third party essentially transforms a one-shot game between two players into a repeated game of each player with a third party. Third party enforcement is traditionally thought of as enforcement by state agencies, e.g., courts or quasi-judicial entities. The literature on enforcement has now come to recognize this category as being immensely diverse. The third party could adjudicate privately in the shadow of formal law, as 'private government' (Dixit, 2004) or it could be for-profit direct enforcement (as in the case of the mafia (Gambetta, 1996)). Another kind of third party enforcement could simply involve the provision of information to various players who then use this as the basis for sanctioning, so that the third party facilitates second party enforcement (for example, credit and quality certification agencies).

The plurality of enforcement mechanisms implies that the choice of means of enforcement rests on the assessment of relative transactions costs, following Williamson's discriminating alignment hypothesis (Williamson, 1996). State mechanisms for contract enforcement are then neither the only mechanisms available nor the most important. In fact, state institutions might be neither sufficient nor necessary for economic exchange.¹² Further, the different means of enforcement (formal and informal) are not mutually exclusive categories; state enforcement, for example, is often embedded in other forms of enforcement (Barzel, 2002). Such a "mixture of both formal and informal relations" (Macneil, 1980) is common across diverse contexts and empirical studies observe that the different means are jointly employed to support diverse kinds of exchange (Macaulay, 1963; Bernstein, 1992; Guo and Jolly, 2008; Johnson, 2002; Johnson et al., 1999; Lane and Bachmann, 1996; Maze and Menard, 2010; Poppo and Zenger, 2002).

These formal and informal mechanisms of enforcement could interact in complex ways, in particular, as complements, where, formal mechanisms strengthen informal enforcement, or as substitutes, where, formal mechanisms replace informal private mechanisms and could potentially undermine or replace self-enforcing arrangements (Lazzarini et al., 2004; Poppo and Zenger, 2002). The complementarity view suggests that the joint use of formal and informal arrangements provides more efficient

¹² For example, Gow et al. (2000) demonstrate that in the Slovak sugar industry self-enforced contracts in the absence of public or third party enforcement increased productivity and efficiency. McMillan and Woodruff (2000, 1999) elaborate on the role of private enforcement for businesses in Vietnam, Otsuka et al. (1986) study the Philippines, Clay (1997) discusses mining rights during the Gold Rush in California and Ellickson (1991) discusses boundary and cattle trespass disputes in Shasta County, California.

outcomes than the use of either arrangement in isolation. For instance, third party enforcement by the state provides a backstop for second party enforcement mechanisms (Klein, 1996, 1991; Lazzarini et al., 2004). Complementarity arguments assert, too, that formal contracts through incentives or punishments can reduce gains from short-term defection thereby increasing the value of honoring informal dealings, what Klein (1996) refers to as the “self-enforcing range of agreements”.

In general, the complementarity view has often taken precedence in discussions of agrarian transactions in developing countries (Fafchamps and Minten, 2001; Maze and Menard, 2010). However, formal contracts can also have a significant “motivation crowding effect” or substitution effect. The prospect of punishments could discourage an individual’s voluntary compliance based on reciprocity norms, thereby damaging the quality of exchange outcomes (Macaulay, 1963; Malhotra and Murnighan, 2002; Sitkin and Roth, 1993). Sitkin and Roth (1993) caution that “legalistic remedies can erode the interpersonal foundations of a relationship they are intended to bolster because they replace reliance on an individual’s good will with objective formal requirements.” Likewise, Macaulay (1963) stresses that detailed negotiated contracts get in the way of creating good exchange relationships between business units. In essence, rules can compromise the ‘handshake ethic’.

These theoretical insights on the plurality of enforcement mechanisms and their complementarity and substitutability offer an appropriate lens to examine agribusiness practice of contract farming in India. In particular, the tension between the ‘motivation crowding out’ effect and complementarity effect is especially valid in the context of enforcement in contract farming systems in India.

ENFORCEMENT, ENFORCEABILITY AND THE CONTRACT

References to Indian customs in early Greek literary sources during the time of Herodotus (5th Century B.C.) suggest that Indians had a reputation for seldom going to law to settle disputes (Singer, 1972). This rings true for agribusiness in contemporary India as well, where contractual relationships are seen more as relationships and less as contracts.

In conversations with agribusiness executives in India, the very mention of the term ‘contract farming’ evokes passionate response. One executive pointed out “We don’t do contract farming, we do relationship farming”.¹³ Another interjected “I call what we do contact farming” leaning forward to ensure one did not miss the point. “We have contact with the farmers, there is no written contract; it is by word of mouth, based on mutual understanding” he elaborated.¹⁴ Yet another said, “I would prefer you called it corporate-linked farming”.¹⁵ Each phrase used to describe their procurement strategy negates the idea of formal contracts that are enforceable by law.

Their careful rewording also suggests that these firms’ executives view firm-farm transactions as a problem of relationship maintenance rather than of contract enforcement. On the one hand, a combination of a languid legal system and the sheer number of farmers involved offers little prospect of economical public enforcement of contracts, pushing firms to rely on informal mechanisms. Indeed, this lies at the heart of arguments that advocate establishing formal, legal mechanisms for contract enforcement. However, on the other hand, even with a hypothetical legal system that works efficiently for agribusinesses in India, the social context of contract farming and the inherent nature of agricultural transactions bestows judicial options for enforcement with limited value. This comes partly from difficulties of non-observability and verifiability of contracts and partly from farmer perceptions of formal legal modes of economic exchange, which could crowd out personalized transactional relationships. The following sections investigate how, in this empirical context, a combination of these elements drive agents to choose certain modes of contracting and enforcement over others.

The Question of Enforceability

First, there is the question of whether the contracts used in contract farming schemes in India are enforceable at all. Given the nature of agriculture, it is virtually impossible to fashion a contract that provides for all possible contingencies in a way that is verifiable by a third party. Contracts are, therefore, invariably incomplete. As an executive observed “Our problem is, these contracts are not actionable. There is nothing we can do in the event of a breach.”¹⁶ Some contractual obligations are only imperfectly

¹³ Agribusiness Survey, Hyderabad, Andhra Pradesh, 2007.

¹⁴ Agribusiness Survey, Hyderabad, Andhra Pradesh, 2007.

¹⁵ Agribusiness Survey, Mumbai, 2007

¹⁶ Agribusiness Survey, Hubli, Karnataka, 2008

observable at the farm level or have a very high cost of detection like the farmers' use of recommended practices or even side-sale of contracted produce. A firm that contracted for marigold (by acreage) in southern India explained how side-selling of the flowers was rampant, especially during the festival season, when the open market prices shot up relative to the contracted price. "Every contract farmer is sending our flowers from the contracted acreage to the open market; each of us has at least fifty farmers to look after, we cannot be in every farm at the same time to detect that."¹⁷

Such de facto non-observability and non-verifiability then renders the outcome of judicial enforcement highly uncertain. Dispute resolution in this case is a probabilistic outcome. A legally binding contract does not offer the kind of guarantee it would for less complex transactions in manufacturing or services. This, in effect, undermines the Weberian notion that 'legal guaranty gives a higher degree of certainty that the promise will be kept' (Weber et al., 1978, page 667).¹⁸

However, it is not merely the lack of predictability of dispute resolution outcomes that is a problem. A shared perception holds among a number of firms that the judiciary in India would give the farmer the benefit of the doubt for political reasons. Especially in a context where the might of large agribusinesses dwarfs a smallholder's power, dispute resolution is widely perceived to be pro-farmer. Essentially, agribusinesses perceive it to be hard to get verdicts against the farmer. As an executive observed "in India, corporates have to be very careful; in any dispute between a farmer and corporate, the firm is always assumed to be the culprit".¹⁹

The problem of enforceability also arises from the way contracts are written. This is not so much an economic perspective of contracts as it is a legal perspective. Still, it has implications for the economic analysis of transactions, since it renders judicial proceedings stochastic.

The Writing of Contracts

*"When I use a word," Humpty Dumpty said in rather a scornful tone, "it means just what I choose it to mean -neither more nor less." -Lewis Carroll, Alice in Wonderland, page 124.*²⁰

*This contract is so one-sided, I am astonished to find it written on both sides of the paper. -Lord Evershed, M.R. quoted in Robert E. Megarry, Discussing a standard form contract, page 276.*²¹

These two quotes sum up many written contracts between farmer and agribusiness in India. Contracts are replete with ambiguity and are often one-sided.

¹⁷ Agribusiness Survey Thalavadi, Sathyamangalam, Tamil Nadu, June, 2009.

¹⁸ The certainty that comes with legal guarantee is what led Weber(1922/1978 edition) to suggest that it would be possible to expand the sphere of voluntary economic exchange because this higher certainty would enable people who did not know each other to transact with one another.

¹⁹ Agribusiness Survey, Mumbai, Maharashtra, 2007

²⁰ Carroll (1898).

²¹ Megarry (1973/2006).

One written contract carries a clause that reads: “This agreement is based on mutual trust and belief” (Singh and Asokan, 2005). Quality requirements are couched in similarly ambiguous terms in the contract –“contract produce at the time of delivery should be of satisfactory quality”.²² There are indeed cases where it is possible to define, precisely, parameters for judging what might be satisfactory.²³ Similar clarity is not offered for the color and appearance of chipping potatoes, for instance, which potentially leads to disputes with uncertain outcomes.²⁴ Likewise, it is hard to imagine that a firm’s contractual commitment that it “shall provide high quality seeds and technical knowhow at reasonable prices” assigns clear, judicable responsibilities to the firm.²⁵

Further, even if one were to assume that the contract document itself did not offer opportunities for interpretative haze, when contracts are written by one party in the form of take-it-or-leave-it contracts, the terms of the transaction are often explicitly (and expectedly) in favor of the firm. Singh and Asokan (2005) find that often, any loss or encumbrance not mentioned in the contract, contracts make growers liable to compensate the company. While a few allowed for compensation to the farmer in the event of the firm violating certain terms of the contract, in others, firms seek compensation for farmer’s breach of contract, while remaining silent on the question of the firm renegeing on its contractual obligations. Other aspects, for instance, involving termination of the contractual relationship, are also often one-sided. ‘The parties hereby agree that the lease shall be discontinued for genuine reasons which shall be decided by the first party (the firm)’ (Singh and Asokan, 2005). Another contract states that at the time of delivery, ‘canneries have the discretion to increase/decrease the quantity of (contracted commodity) to be supplied’.²⁶

Should contract breach make it to courts, firms would run into another problem. The writing of contracts in India today involves no participation of the farmers. In most legal traditions, such non-involvement of farmers in drafting contracts to which they are party would make these contracts non-judicable. Acceptance, in judiciary terms, needs to be a ‘valid acceptance’. As Sridevan (2006) elaborates, to be faithful to the Indian Contract Act, the relevant piece of legislation for agribusiness-farmer contracts, every clause in the agreement needs to be discussed, negotiated and then finalized, once there is consensus on each point. The contracts in use in contract farming schemes suggest otherwise. Indeed, farmers across schemes seek an opportunity to draft the agreement and “assist in the wording of

²² Contract provided by agribusiness in Andhra Pradesh, April 2007. Contract details are proprietary. Citations reflect this.

²³ For example, in papaya contracts, firms use a device called the Brix meter to measure papain activity in latex in papaya contract farming by gauging the refraction and translucence of the latex which in turn indicates papain content, a minimum of which is required as per the contract. This device is easy to use and the farmers have an opportunity to measure it themselves.

²⁴ In the state of Jharkhand, when a multinational chipping company rejected payment to farmers for their small potatoes claiming that they couldn’t process these, the farmers confronted the firm with chips packets, demonstrating that the firm was in fact processing even the smallest potatoes. Agribusiness Survey, Ranchi, Jharkhand, 2008.

²⁵ Contract provided by agribusiness in Karnataka, November 2007.

²⁶ Contract provided by agribusiness in Punjab, March 2007.

specification in terms the farmer can understand”²⁷ and demand that the “management ensures that farmers know what they are signing”.²⁸

It is not clear that farmers understand the specific commitments implied by their signature. This is despite an explicit statement of acceptance of the terms laid out in the contract. The Farmer Survey reveals that while a number of farmers did understand the legality of the contract, a number of others were not sure what was meant by a contract document. They were not sure if the ‘passbooks’ they had were, in fact, contracts.²⁹ This is owing partly to farmers being unaccustomed to formal transactions, a related absence of understanding of the import of contracts, and partly due to illiteracy.

Interestingly, farmers often maintain a contract in someone else’s name (usually a member of the farmer’s family “who has brought luck in the past”). In some cases, these were toddlers, in others, deceased family members. The contract is then signed by yet another person (cousins, extended family and so forth), while the actual contractual obligations and cultivation are carried out by the farmer. In the Farmer Survey, several names on the contracting firms’ roster of contract suppliers were of toddler-children of the farmers.

The Farmer Survey shows that only a half of all contract farmers who signed contracts kept a copy (Table 1), ranging from a tenth to four-fifths across the schemes.³⁰ Fewer still (44 per cent) had read them or knew of its contents through other means. Importantly, a significant proportion (37 per cent) who had signed contracts did not think it was valid in court. Less than half thought the contracts were legally valid, and 14 per cent were not sure. This is true across schemes, although to varying degrees. It is interesting, for instance, that in the broiler subsector, only a small proportion stated that they had signed written contracts. Yet, almost all of them considered these valid in court. In contrast, in the papaya contracting scheme, while an overwhelming proportion had written contracts, almost all the contract farmers believed these had no legal validity.

²⁷Interview with farmers, Coimbatore, 2008.

²⁸Interview with farmers, Dindigul, 2008.

²⁹ In some schemes, firms hand passbooks to contracting farmers, in which transactions are recorded whenever there is transfer of inputs, credit or produce.

³⁰ It must be noted here that the Indian Contract Act deems oral contracts admissible in courts provided there is evidence of such a contract. In general, such proof is not available in the context of contract farming schemes in India.

Table 1: Modes of Contracting and Farmer Awareness of Contracts

Details	Average among all schemes (%)	Range across schemes (%)	Number of respondents
Percentage of farmers who have a written agreement	54	18-90	438
- Percentage of these who have a copy	52	9-82	
- Percentage of these who have read it or had it read to them	44	22-67	
- Percentage of these who believe it is valid in court	49	0-58	
- Percentage of these who are unaware if it is valid in court	14	0-40	
- Percentage of these who think it is not valid in court	37	2-100	
Percentage of contract farmers who contracted as part of a group (See note 2)	44	14-95	158
1 The data uses responses from Phase 1 and Phase 2 of Farmer Survey			
2 This figure for group contracting pertains to only the Phase 1 farmers in cotton and gherkins.			
3 All figures have been rounded off to the nearest whole number.			

In general, this absence of farmers' clear understanding of their legally binding contractual obligations raises interesting questions about whether the courts would in fact consider these contracts valid and uphold farmers' acceptance of their obligations. This contributes to uncertainty in judicial outcomes.

Costs of Enforcement

Even if it were possible to write out complete, verifiable contracts, farmers and agribusinesses in India encounter public institutions for enforcement that are expensive relative to the loss associated with the contractual dispute. The proverbially slow legal machinery in India, caused in part by a backlog of pending cases, almost guarantees long waiting times.³¹ This prevents new cases from entering the court system without a very good incentive.

Given that firms transact with a large number of farmers for very small quantities, often the costs of legal action exceed any claim firms could realistically hope to recover. Further, most contractual disputes would be on a case-by-case basis. This implies that for the firm, every farmer taken to court, however small the transaction, entails a fixed cost.³² As a procurement officer put it, "we had a big problem with enforcement, but it is simply not worth going to court."³³

³¹ As on October 31, 2001, 20.3 million cases were pending in the district and subordinate courts, 3.5 million in the High Courts and 21,995 in the Supreme Court (Parliamentary Standing Committee on Home Affairs, 2003). Normal adjournments in Delhi's courts, for example, are for 4-6 months, the trial dates are not available before 2 years and settlement of suit takes place over 15 years (Upadhyay, 2003).

³² Procedurally, in most legal systems, even mass standardized contracts would not admit class libel and would have to be decided on a case-by-case basis (Inc, 1949). This is necessarily the case, therefore, for individual contracts.

³³ Agribusiness Survey, Hubli, Karnataka 2008

As an illustration, consider the data on defaults by farmers in a gherkins contract farming scheme in Tamil Nadu. Farmers are offered inputs on credit at the time of sowing, agreeing that when the contract produce is delivered to the firm, the amount owed against inputs is adjusted and the farmer is paid the net amount. For various reasons, such as yield risk and side-selling, the farmer often ends up delivering less than the expected commitment and hence becomes indebted to the firm. Firms are left with the choice of writing off the outstanding debts, carrying it over to the next season, or attempting recovery, either through private means or through courts. It is not unusual in contract farming schemes in India to have a very large number of defaulting farmers, each with a very small debt. In this example, 37 per cent of contract farmers in the study area had some default (485 out of 1296 contracting farmers), but the average value of default was only Rs.3750 (approximately US \$78).³⁴

In this example, assuming an enforcement cost of Rs.5000/farmer, the firm could seek court enforcement for about 124 of them (approximately, 26 per cent of all defaulting farmers), without incurring fiscal losses, assuming full recovery of outstanding dues. This figure drops as enforcement costs increase. At Rs. 12500/farmer, it would make sense for the firm to incur this enforcement cost for only 14 farmers (less than 3 per cent of defaulters), again assuming complete recovery of dues.³⁵ Indeed, the gherkins firm in question asserted that legal recourse emerges as a less-preferred option given the relatively small recovery amounts per farmer and the large number of farmers who are culpable. Firms express a willingness to “let it go” if the volumes or defaults are small and even larger amounts if they trust the farmer not to have diverted contracted output.³⁶

The farmers’ enforcement options are far more limited, especially given that most contracts explicitly favor the firm; most often this involves opting out of contracting itself. Few ever go to court (about 1 per cent of the respondents in the Farmer Survey), partly because for many farmers, recourse to legal redress is practically out of reach, if not in terms of monetary costs, in terms of other barriers such as legal literacy, demands on time and access to legal assistance.

THE IDEA OF A CONTRACT: PRIVATE ORDERING IN THE SHADOW OF THE LAW

Given that both enforceability and enforcement are problems in equal measure, what is the role of the contract itself in these contract farming schemes? Is it conceivable that if enforcement were not a constraint, firms would treat contracts as legally binding instruments, preferring these to informal arrangements? Interviews with agribusiness indicate that such a scenario is unlikely.

³⁴This is equivalent to the retail value of eight, 12-oz. jars of gherkins pickles or around 220 kgs. of the highest grade of contract output, which is 0.05 per cent of what was eventually procured that season in the study area.

³⁵ This was collected from interviews with agribusinesses in Tamil Nadu, but is a crude ballpark figure.

³⁶The firm may still choose to strategically enforce contracts to induce future compliance. This is taken up in a following section.

First, the very fact that a contract tries to be specific and rigid in defining contingent claims is, in the firms' view, a disadvantage, since the firms lose 'flexibility' (Klein, 1996). Gow et al. (2000) observe in the context of Slovak sugar industry that firms often value the flexibility that comes with informal arrangements. In India, for instance, the year 2008-09 saw gherkins processors lose international orders on account of the global economic slowdown; many firms had contracted far more than they wanted. At times like this, an executive explained, "we would like the farmers to cheat and side-sell to other companies. That would actually be a great help! But the contract obliges us to buy what they produce, even though we have no orders".³⁷

Importantly, the social context these firms operate in influences agribusiness attitudes to the contract as a legal instrument. The very idea of a contract carries little meaning when few farmers understand the document they are supposed to sign. In fact, in some parts of India, fly-by-night operators have duped farmers of their lands, while the farmers had no idea that they had signed away their land as collateral. Several such cases have been reported in the state of Orissa in recent years.³⁸ In much of rural India, the idea of committing to anything in writing is often disconcerting to the farmer. "If you go to a farmer with a pen and a document, you can be sure he will run away", said a field official, explaining how the company first establishes contact before explaining the procurement arrangement to the farmer.³⁹ This can often be a long process and some farmers take years before accepting to grow produce for the company. Firms thus tend to believe that for contract farming relationships, "trust is a precondition, whereas a contract is not, absolutely not."⁴⁰ This sentiment is pervasive. Said one executive: "what is the use of contract? You can't do anything with it anyway. Trust is a hundred times more valuable than a contract".^{41,42}

The firms typically claim that they are unlikely to ever take legal action for breach of contract. One firm's executive pointed out that it was a very sensitive issue, politically. "In our country, we can't go after the farmers, it is not even right to go after them in case of breach -you can't fight the *annadatas*".⁴³

Another agribusiness executive explained that "even if contracts were easily enforceable in courts, that is not the way you work with farmers. You need to establish a relationship with them. The

³⁷ Agribusiness Survey, Dindigul, Tamil Nadu, 2009.

³⁸ Personal communication with Action Aid (India), Bhubaneswar, Orissa, March 2007.

³⁹ Agribusiness Survey, Secunderabad, Andhra Pradesh, 2009

⁴⁰ Agribusiness Survey, Hyderabad, Andhra Pradesh, 2009.

⁴¹ Agribusiness Survey, Coimbatore, Tamil Nadu, 2008.

⁴² While it is conceivable that that exogenous change in education, literacy and awareness would assist transition to contract-based relationships, it is unlikely that court-aided enforcement would ever render trust irrelevant, as has been pointed out repeatedly even in developed countries (Macaulay (1963), for instance).

⁴³ Agribusiness Survey, Mumbai, Maharashtra, 2007. The term *annadatas* means 'givers of food' and carries the connotation of a noble profession.

loss from breach is easily made up; a relationship that is strained is not!”⁴⁴ Another executive said, “governments don’t understand these things. You can’t force farmers to enter into paper contracts with some third party settling disputes. That would make it impossible for us to work with them.”⁴⁵ In the case of Maharashtra, while the stated reason for the poor response of agribusinesses was that these laws were not sufficiently well-publicized, industry sources felt that both firms and farmers preferred “informal arrangements based on trust, experience and market dynamics instead of having a formal arrangement”(Ghadyalpatil, 2008).

Indian agribusinesses typically articulate a concern that the motivation crowding out effect or substitution effect might outweigh the complementarity effects of formal mechanisms, that formal agreements might undermine voluntary compliance and hence the self-enforcing nature of arrangements. Firms appear to factor in the substitution effect seriously in their contracting decisions, ensuring, even in the context of formal written contracts, that the highly personal and customized nature of engagement is not undermined. This is sometimes evident in the contract document itself. For example, one of them reads: “In case of any dispute with regard to the lease between the parties, the same shall be settled by mutual discussion” or, as another puts it, disputes will be “endeavored to be solved through dialogue”.⁴⁶

The Farmer Survey reveals that private order enforcement dominates overwhelmingly as the means through which transactions are maintained, with law playing only a peripheral role, if at all (Table 2). Only 6 per cent of those interviewed as part of the Farmer Survey thought the firm would take them to court, if the farmer breached the contract. More than a fifth of the farmers felt that the firm would attempt to recover outstanding amounts privately, through field officers, by complaining to village leaders and local representatives and so forth.

Firms often rely on repeated interaction over the long term to discourage farmers from breaching contracts. “We are so big, that none of them can afford to burn bridges. At some point of time if not now, at some time in the future, they have to sell to us. No one can hope to avoid us completely all the time, so this helps and encourages them to keep up their commitment.”⁴⁷ Across schemes, farmers seem to know this. A majority of 35 per cent of the respondents in the Farmer Survey said the firm would stop contracting with them in the future if the farmer breached the contract in some way.

In some cases, it is a form of collective punishment. “As a rule, we always tell the farmers, if any of you cheat we will boycott the village and even the good ones will lose out. This works a bit, but there

⁴⁴Agribusiness Survey, Hyderabad, Andhra Pradesh, 2007.

⁴⁵Agribusiness Survey, Coimbatore, Tamil Nadu, 2008.

⁴⁶Contracts provided by firms in Tamil Nadu and Andhra Pradesh, 2008.

⁴⁷Agribusiness Survey, Kangeyam, Tamil Nadu, 2007.

are always a few who cheat.”⁴⁸ In still other cases, reputation plays a big role. The gherkins cluster in Karnataka and the poultry cluster around Coimbatore in Tamil Nadu have developed a system where they inform one another of ‘blacklisted’ farmers. While the gherkins firm felt it was beginning to work, the poultry firms were still refining the system. In the initial phase, they did not anticipate that farmers would approach other companies through other family members and sometimes alter the name of the farm to escape recognition. The firms were now working to identify farmers by the survey number of the plot they owned.⁴⁹

Table 2: Farmer Perceptions of Enforcement in Select Schemes

What would the firm do if you breached the contract? (%)	
Stop contracting, deny advances or credit	35
Attempt recovery through appropriate action, not pay us	21
Warn us or do nothing	15
Go to court	6
Others	14
No response	9
What would you do if the company breaches the contract? (%)	
Stop contracting and /or switch firms	36
Give up the contract crop altogether	13
Nothing, we are powerless	32
Make a representation to the firm, complain to other authorities, demand compensation	17
Go to court	1
Others	1
Total Number of Respondents	484
1 The data uses responses from Phase 1 and Phase 2 of Farmer Survey	
2 All figures have been rounded off to the nearest whole number.	

As Galanter (1981) points out, the plurality of enforcement mechanisms available implies that as the parties come to terms with the intrinsic limits of court ordering, they craft their own transaction-specific contractual supports that involve private ordering. As agents recognize that their purposes are served by continuity and cooperation, the concept of contract as legal rules gives way to the more flexible concept of contract as framework, or a focal point. A contract is then incomplete and ‘almost never accurately indicates real working relations, but affords a rough indication around which such relations vary, an occasional guide in cases of doubt, and a norm of ultimate appeal when such relations cease in

⁴⁸ Agribusiness Survey, Hyderabad, Andhra Pradesh, 2008.

⁴⁹ Another relatively recent development is a whole class of contracting intermediaries who have emerged as aggregators of contract produce for the firm, called vendors or agents. This is particularly true for firms that operate on a large scale. They are involved in selecting and maintaining farmer relationships on a commission basis, not unlike traders in traditional market channels. This appears to be the firms’ response to get the incentive-moral hazard problem right, and from the perspective of this work, it outsources enforcement, in a way. This paper focuses purely on the firm’s field officers functioning at the firm-farm interface or as ‘boundary’ persons.

fact to work' (Galanter, 1981; Llewellyn, 1931). The contract document is then something of a social artefact or a social representation of a relationship (Suchman, 2003).

In the Indian setting, the contract is, at best, a tool to declare seriousness of intent or to initiate a process of discussion with the farmer for better clarity of the terms of the transaction. Thus, even if the contract is rarely (meant to be) enforced, contract agreements help to spell out clearly the rules of a relationship (McMillan and Woodruff, 1999). One representative of a firm that contracted for gherkins stated that even though the chances of litigation were minimal, they were investing a lot of effort in making the contracts tighter and more specific so that the farmer understands the parameters of engagement well. Another agribusiness representative stated, "We have written contracts but they are of no use. They are not legal binding; but they are moral binding. Every year about 5-8 per cent of the contract farmers deceive us, but others have integrity."⁵⁰

At other times, rather than serving as a mechanism to ensure that farmers honour their commitment, the contract is a defense mechanism for the firms so that should the farmer approach the courts they have adequate protection. This explains, in part, why contracts are one-sided. A procurement manager explained, "Sometimes the farmer can also be unreasonable. We once had a notice from a lawyer suing us for Rs.4 lakhs (approximately US\$ 8500). The farmer blamed us for his low yields. We countered it by saying that he had not really followed the practices and the contract clearly states that the farmer is expected to follow the recommendation. His fields were waterlogged and we had already advised him. The court saw the point."⁵¹

When viewed in these terms, it is possible to read the terms of the contract differently. What seems like ambiguity from a legalistic perspective is now consistent with the purpose of the document, that is, when there is such a thing as a document.

On those rare occasions when the firm does sue the farmer for breach in contract, a very different logic is at work. For instance, in 2007, a contract supplier for a broiler firm sold the entire stock of over 6000 birds to a wholesaler even though the contract expressly forbade this. The broiler firm decided to take him to court. There were other things the firm could have done, a multilateral strategy, for instance, where all broiler firms would boycott the farmer.⁵² However, such a coordination mechanism had run into difficulties since they were unable to establish the identity of defaulting farmers with certainty.⁵³ Further, the wholesalers, the alternate market channel, were outside their network, so the penalty for the farmer

⁵⁰ Agribusiness Survey, Belgaum, Karnataka, November 2008.

⁵¹ Agribusiness Survey Hubli, Karnataka, November 2008.

⁵² In the broiler industry in Tamil Nadu contracting firms tend not to cross-purchase, so that the side-selling usually occurs with wholesalers in the open market.

⁵³ This is because the farmers often used names of firms for their farms while signing the contract, changing these if they did default. So too with individuals, who typically signed contracts in the name of different members of the family each time they signed a new contract.

would not be effective. The case had been going on for two years and an executive confessed that they had spent far more money than the loss they incurred. “But”, he said, “we feel that this sets an example. We show other contract suppliers that we will not take it lying down. From that perspective, we think, rather, we hope that it is worth it.”⁵⁴ There are similar cases where the firm has successfully sued intermediaries who sub-contract with farmers. Their experience has been that this reduces the chances of cheating.⁵⁵

This can work both ways, though. One executive confessed “we would never take a farmer to court; it would jeopardize relations with all the farmers and not just the one who defaulted”.⁵⁶ There is a pervasive sense among contracting firms that suing a farmer would effectively scare away or lose them all their contract farmers the following season.

Here, we see evidence that third party public enforcement mechanism goes beyond a backstop and is quite differently embedded in a set of multiple enforcement mechanisms. Legal recourse is not the last resort. Rather, it becomes an instrument of information transmission and conveys a set of incentives through a demonstration effect but at the same time, could potentially transmit disincentives as well. Firms need to factor in this tradeoff between the complementary and substitution effects of formal contracts and their enforcement in their procurement and enforcement decisions.

THE MORAL ECONOMY OF CONTRACTS

It is evident from the above that farm-firm contractual relationships in India are viewed in very broad terms. This is indeed relationship farming more than contract farming. An agribusiness executive likened the firm-farmer link to a marriage, “you have to work at it until you die, there may be lots of ups and downs, but you have to stick with it.”⁵⁷

There is ample evidence in India of what scholars have noted to be true of contract farming schemes in other developing countries, that there exists a “moral economy” of the contract (Clapp, 1994). This moral economy of the contract offers a space wherein firms reward the “ostensible observance” of the salient terms of the contract by farmers by overlooking minor transgressions (Clapp, 1994; Scott, 1976). The firm-farmer relationship occupies a space larger than that defined by the contract; even as everything in these ‘contracts is not contractual’ (Durkheim and Bellah, 1973), extra-contractual

⁵⁴ Agribusiness Survey Coimbatore, Tamil Nadu, 2009.

⁵⁵ Agribusiness Survey Dindigul and Nilakkottai, Tamil Nadu, 2007.

⁵⁶ Agribusiness Survey, Mettupalayam, Tamil Nadu, 2007.

⁵⁷ Agribusiness Survey, Hyderabad/Ranchi, 2008.

interactions between the firm and farmer influences contract performance, for instance, by altering the incentives for compliance.

For instance, many field officials working to monitor crops and offer technical advice to the farmer often end up helping the farmer with other crops as well, teaching them about pesticide use for non-contract crops, crop planning and so forth (Table 3). Nearly a fifth of all respondents in the Farmer Survey had sought advice from the field staff of the contract firm for crops other than the contract crop. The nature of inputs sought range from specific actions to tackle problems with specific crops to a much broader engagement seeking general advice on new technologies, crops and markets, cultivation practices and so on. Some firms employ workers from farming families, many of whom are contract suppliers. While the Farmer Survey does not provide cases of this, it is apparent that the firm-farm relationship for those families who transact with the firm for both wage employment and supplier of produce, could enhance the durability of the relationship.⁵⁸ The Agribusiness Survey reveals too that several firms directed Corporate Social Responsibility activities to contract villages, including donations to schools, village festivals, conducting medical camps, etc. Larger agribusinesses leverage goodwill created over the years through their community engagement to put contract farming arrangements in place.⁵⁹

Such non-contractual actions influence tacitly, and positively, the contractual performance of farmers. Often there is ex-post-forgiveness of deviations from the contract and a large class of actions is pardoned as ‘excusable breach’ (Fafchamps, 2004). In general, the moral economy of a contract implies explicit recognition of ‘excusable breach’ on account of reasons the field agents deem as being beyond the farmers’ control or too minor to merit enforcement (Fafchamps, 2004).

Often, breach is not literal or obvious. There are many elements to a contract and even when there is not an obvious violation of the salient terms of contract (i.e., delivering the produce of a given quality at a particular time and place) the terms of engagement can be subverted by farmers in many ways.

For instance, several contract farmers are known to the firm to use contract inputs for non-contract crops (called ‘input diversion’). According to the Farmer Survey, 17 per cent of the farmers admitted to input diversion in the most recent contracting season. Often, contracts oblige farmers to follow recommended cultivation practices. Many do not. “Our procurement takes place from 25,000 farmers, of whom about 65 per cent really follow all the technical information we provide”.⁶⁰ In other cases, it can get more innovative. Some marigold contract farmers soak the flowers before they deliver to the company so that they weigh more. Sometime papaya latex is adulterated with flour, sometime with

⁵⁸ This parallels the contract interlinkage literature, e.g., Braverman and Stiglitz (1982).

⁵⁹ These firms, especially, see the grafting of formal contracts onto their preexisting relationships as detrimental to the trust that has been built over the years, undermining farmer-firm relationships.

⁶⁰ Agribusiness Survey, UgarKhurd, Karnataka, November 2008.

water. “One season, they got our laborers to adulterate our latex with water. But for the farmers, we are their *adaikalam* or refuge. They went astray but all of them have come back to the fold.”⁶¹

Table 3: Kinds of Breach and the ‘Moral Economy’ of Contract

Details	Average for all schemes	Range across schemes	Number of respondents
Percentage			
- Who diverted contract inputs for non-contract crops	17	0-26	481
- Who engaged in sideselling the previous season (self-reported)	17	2-64	484
- Of other farmers in the village who engaged in side-selling the previous season	12	0-26	484
- Who received advice for other crops from the field official	19	0-43	475
Percentage unable to deliver on the contract at least once in the past	44	0-88	484
The reason for this in the last such instance			
- Weather or yield loss	52	35-65	
- Urgent need for cash	15	10-25	
- Market or competitor price was higher	10	6-22	
- Firm delayed or did not show up	5	0-18	
- Produce fell short of quality standards	5	5-19	
- Personal reasons (e.g., death in the family)	13	9-19	
Percentage who felt the firm had not honoured the contract in the last season	10	0-23	438
Percentage reporting rejection of some contracted produce	45	9-97	475
Ratio of days until full repayment under contract (relative to alternate market)	7*	1-27	381
1 Data pertains to Farmer Survey, Phases 1 and 2 2 Figures have been rounded off to the nearest whole number 3 The total number of respondents varies depending on the category of farmers who were asked the question. Some questions were addressed only to currently contracting farmers, others were addressed to both current and former contract farmers, and so on. 4 * This figure is a pure number, not a percentage.			

The more blatant kind of contract breach by farmers is side-selling. It is common for firms to contract acreage, obliging the farmer to sell the entire crop harvested from the contracted acreage to the firm. Sometimes, farmers divert contract produce to other buyers who pay more at the time of harvest. In the Farmer Survey, 17 per cent of the farmers admitted to have sold at least some part of the contracted produce to buyers other than the contract firm during the most recent season they contracted (Table 3).

⁶¹Agribusiness Survey, Oddanachattram, Tamil Nadu, 2007.

Despite side-selling being a clear breach of contract, it is sometimes on account of personal exigencies. Firms recognize this, often saying, “we don’t penalize the farmers for doing that. They are not entirely to blame. Sometime they need cash urgently, so they sell to someone else.”⁶²

Indeed, the Farmer Survey suggests that in general, about 44 per cent of the farmers have been unable to deliver the contracted produce as promised at least once in past (Table 3). More than half the farmers who admitted this was the case attributed their violation to crop loss due to pests or the weather. Close to 15 per cent of them said they sidesold only because they were in urgent need of cash. Another 13 per cent were unable to deliver owing to personal reasons, like a death in the family or illness. These were typically overlooked by the firm as excusable breach. One executive, like his counterparts elsewhere, put things in perspective “We found that whereas the loyalty was 92 per cent in 1995, it has now dropped to 82 per cent thanks to the other plants encroaching. Farmers sell to them because of many reasons. Sometimes, they are in need of cash. At other times, they want to sell (and harvest) earlier than we recommend so that they can accommodate another crop. Also, there are some mills that outprice us after we announce our price. But, we have been here about 60 years and we are the largest, so we are not under major threat. In our company, loyalty of farmers is high.”⁶³

Only when the transgression exceeds limits does the firm actively seek to enforce, by whatever means they deem appropriate. Many firms that are committed to maintaining trust often take huge losses. “We succeeded in contract farming because we did not reject or refuse to accept produce, once we had got what we want. We used to take it even if we did not want it.”⁶⁴ Another procurement officer said that there were seasons when they weighed the produce, paid the farmers and emptied it into the mud to discard. In one scheme for medicinal herbs, operating in Karnataka, the firm specifies in the contract that should the firm fail to take delivery of contract produce, it would cover the expense and arrangements to sell in the open market.

From the farmer’s perspective, knowing that this moral economy offers space for minor transgressions prompts them to maintain the system. They offer similar room for the firm’s transgressions and address these by raising the relevant concerns with the firm’s officials or field agents. In the Farmer Survey, 17 per cent of the farmers said they would approach the firm if they found that the company had breached the contract.

About 10 per cent of the farmers in the Farmer Survey felt that the contracting firm had not honoured the contract in some way in the most recent contracting experience (Table 3).⁶⁵ The firms’

⁶²Agribusiness Survey, Karamadai, Tamil Nadu, 2007.

⁶³Agribusiness Survey, Dharwad-Belgaum, Karnataka, 2008

⁶⁴ Agribusiness Survey, Coimbatore, Tamil Nadu, 2007.

⁶⁵This is likely an underestimate, since in some survey villages farmers were reluctant to discuss this issue, fearing that doing so would jeopardize their relationship with the firm.

breach of contract can be just as varied as the farmers'. It is not confined to a refusal to show up to buy the contracted produce and is often more insidious. Firms could instead establish non-transparent quality standards, reject produce arbitrarily and alter prices when the produce is delivered. It could even offer harmful technical advice. A few farmers in the Farmer Survey mentioned that firms recommended chemicals that kill the standing crop if they have obtained sufficient supplies. Farmers stated that this often depended on the field officer and a few of them mentioned this had happened in the most recent contracting season. There could be other issues as well, as a particular NGO employee, who was mediating the firm-farm relationship, explained "Our agreement was that seeds would be delivered on such-and-such date and harvest and delivery at the factory gate would happen at a certain date. In practice, the delivery of seed takes a time-span. It is sent in lorry loads and there is almost two weeks separating the arrival of the first consignment and the last consignment. So the farmers who sow last, nevertheless have to harvest the potato on the given date, so these potatoes all tended to be under-sized; they were harvested prematurely. These are rejected. So the firm actually controls the supply by regulating timing of seed delivery".⁶⁶ In broiler contract farming, the firm's need to have control over total market supply to influence prices implies that they often contract for fewer growing cycles per year than they originally promise the farmers. The Farmer Survey reveals for instance, that in 2009, while contract growers were promised six batches that year, 43 per cent of the growers were offered only five batches, 48 per cent were offered four, and the rest had to settle for three or fewer batches that year. Other ways in which the firm dilutes its commitment include delayed payments for contracted produce, or late lifting or evacuation of contracted produce (which results in higher rejection rates or sub-optimal weights).

But, as with firm response to farmer breach, it is only when the firm's breach inflicts a cost beyond what is perceived to be reasonable to the farmer, that the supplier revisits his/her decision to contract. In general, farmers are in a weaker position, relative to the firm, unless there is a viable alternate market and one where collusion among buyers is not possible. Close to a third of farmers say that they are powerless to do anything in the event of the company breaching the terms of the contract. Again, this goes back to the way contracts tend to be written. Close to half would stop contracting with the firm, switch firms or give up the contract crop altogether (Table 2). A few farmers also stated that they would not let the concerned firm step into the village again if they violated their terms of the contract. The Farmer Survey suggests too, that in the event of the company breach only 1 per cent of the farmers would attempt to go to court.

Given the contract farmer's weak position in a contractual arrangement, the ability to side-sell, to stop contracting or to switch firms is what gives farmers agency and depending on the particular market

⁶⁶Agribusiness Survey, Ranchi, Jharkhand, 2008

structure for the contract commodity, can redress, partly, imbalance in the contractual relationship.⁶⁷ The exit of farmers itself offers a signal to the more responsive firms, who then have an opportunity to assess their own contractual performance and make necessary adjustments in order to survive. This is particularly the case when there are competing firms that offer contracts to attritioning farmers.⁶⁸ Interviews with businesses that have survived suggest that most respond with new arrangements that work on the participation constraint of the farmer, where a contracting firm has to make offers at least as attractive to the farmer as the next best option available. In 2007-08, there were so many firms contracting gherkins in the study area that firms had begun to offer cash gifts and vacation packages to the farmers to induce them to contract.

In general, the centrality of personal relationships in contract farming systems in India is manifest in the way firms identify and conduct business with farmers. The process of identifying farmers with whom to contract differs substantially across schemes. For both papaya and poultry, the identification of farmers is primarily through social networks and contacts; 57 per cent of papaya contract farmers and 95 per cent of broiler growers entered into contracts based on preexisting social relationships with the firm's employees. For marigold and gherkins, the firms tend to identify a small region and then canvass in the villages within that region for farmers who might be willing to contract. Only 8 per cent of all gherkins contract farmers and about 12 per cent of marigold contract farmers were selected based on social networks. Once the contracting arrangement is in place, field officers of all the firms in the survey interact closely with the farmers in a highly personalized way, partly owing to the need for oversight of the production process. In the case of broilers, field officials visited the farmer every day, for gherkins and marigold this was three to four times a fortnight. For papaya at the nursery stage, field officers visit contracting farmers daily, tapering off their visits once the tree attains maturity.

The primacy of trust and relationship both enables informality in contracting and is also a result of the absence of legally valid written contracts. It is common in the contract farming literature to see a scheme described in categorical terms as being formal (written contracts) or informal (oral agreements) or as contracting with groups or individuals. In contrast, the Farmer and Agribusiness Surveys suggest that firms engage with farmers in different ways depending on what works for each farmer, so that even within the same scheme there is a mix of formal and informal, of oral and written contracts, of group contracting and individual contracting, etc., although the major terms of the contract might be shared. It is 'contact'

⁶⁷Swinnen (2007), for instance, discuss the effects of competition on rent distribution and the welfare implications for farmers.

⁶⁸This is reminiscent of Hirschman (1970)'s thesis on exit, voice and loyalty, which suggests that the firm's ability to respond to exit and voice would contribute to maintaining the system. In another sense, this also bears out the view that competition among contracts leads to convergence in forms (Eggertson, 1990). In most commodities, competing firms end up offering remarkably similar terms of contract, at least on paper.

that enables field officials to determine where an oral contract would work better than a written contract or where it is appropriate for farmers to contract as groups rather than as individuals.

CONCLUDING REMARKS

This paper provides empirical evidence that emphasizes that in the context of India legal contract enforcement is peripheral in the context of contract farming practice, as personal relationships underpin virtually all effective exchange. This is related only in part to the costs and inefficacy of formal enforcement mechanisms. Given the large number of defaulters, and the relatively small amounts of default, the costs of enforcement imply that the firms can only profitably recover these outstanding amounts from a fraction of them. This excludes other costs in terms of waiting times and firm's reputation. Indeed, this latter consideration drives firms to avoid legal mechanisms for contracting and enforcing, whenever feasible. An equally important reason is that firms tend to view court-based formal enforcement as detrimental to farm-firm relationships in a way that undermines the handshake ethic. Contract farming arrangements therefore hinge on notional contracts that allow for a moral economy to operate in transactions. It is important therefore to acknowledge the primacy of personal relationships in contract farming arrangements in India. If this is true, then public policy aimed at legal institutional development to incentivize actors to enter into contract farming arrangements, and considering these to be necessary and sufficient, is ineffective if not misplaced.

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