

AGRICULTURAL PRODUCTION CONTRACTS AND FOOD SAFETY

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Abstract

Food safety is currently one of the most urgent issues in both EU's and global agriculture. One of its basis tool might be the cultivation contract that is strictly related with the process of production and supply in agriculture.

The contract in question has numerous functions, which are modified along with the technological progress. However, it should still be seen as the main stem of the system supplying raw materials for the agri-food industry. The contract plays a huge role in the agro-logistics chain. It covers such elements as planning, gathering, controlling and flow of the materials that are directed to the processing or sell. Besides, it should be perceive as a legal instrument limiting broadly understood risk in agricultural production.

The aim of the article is an attempt to indicate the role of the production contract in providing the food safety. The article also aims to answer the question what safety issues might be covered by such a contract to fulfill the general safety standards.

Key words: agricultural production contracts, production risk, food safety, agri-food industry, food chain.

Introduction

An agricultural production contract is a contract by which a producer (“grower”) agrees to produce and deliver all of a designated crop raised or agrees to feed and care for livestock in a manner set forth in the agreement to a contractor (quite often processor). The producer is paid according to a formula established in the contract. Such a contract usually specifies in detail the production inputs to be supplied by the contractor, the quality and quantity of the particular commodity involved, the production practices to be used, and the manner in which compensation is to be paid to the producer. The Polish Civil Code defines contract farming as “a farmer commitment to produce and supply to the contracting party a specified quantity of agricultural produce of a given time, and the contracting party commits to collect the produce at an agreed time, pay the agreed price and make a specified additional performance if the contract or specific regulation provide for the obligation to make such performance⁴. The quantity of agricultural produce may also be specified in the contract according to the area from which the produce is to be gathered (Article No 613 of Polish Civil Code, 1964).

Due to remarkable process of transformation in the agri-food sectors, contracts are an increasingly important aspect of agricultural production. They raise concerns about market transparency, possible consequences for contract's parties of the food supply chains and the role of a legislator and government in the changing environment (Wu, 2003). Thus it is very important to determine the “nature” of production contract, as the food safety instrument, that will be comprehensible, concise and possible to fulfill by both parties – the agricultural producers and the processors.

⁴ A farmer also means a group or association of farmers.

It is safe to assume that the agricultural production is no more the autonomous production. It is covered by multi layers structure, called coordination. The contract coordination from the farm through the processor to the consumer is intended to ensure that quality and other product specifications are met. Quality incentives for various players along the vertical chain often are needed, and technology transfer (e.g., specialized inputs, buildings) by processors to use by growers may occur. Therefore it is important to separate the food safety notion from both farmer and processor/consumer point of view.

Materials and methods

The objective of this paper is to indicate the role of the production contract in providing the food safety. The article also aims to answer the question what safety issues might be covered by such a contract to fulfill the general safety standards.

This objective has been achieved in two stages. The first step was to identify and analyze the legal definition of food safety. That was based on the European Union's and Polish legislation and followed by brief legal characteristic of contract nature based on Polish Civil Code. Because of the wide scope of contracts' significance, only some of them were chosen to further research. Next, taking into consideration that the production contract has fulfilled the assumptions of the concept of food safety, the contract's impact on the selected stages in agri-food chain have been presented according to this concept. The analysis of theoretical approaches based on literature has been enriched with legal and economic literature and the observations made by the author. The main methods applied in the article were the dogmatic analysis of the EU and national regulations as well as the descriptive method.

Results and discussion

Food safety is a flexible concept, reflected in many attempts at definition in research and policy usage. It might be understood as scientific discipline describing handling, preparation, and storage of food in ways that prevent foodborne illness.

Food safety is the term that has its own legal definition. Although the legislator has not determined it directly, in positive sense. He has framed it in reverse. According to Article 14 of Reg. No 178/2002 food shall be deemed to be unsafe if it is considered to be injurious to health and unfit for human consumption (Guidance, 2010) Such food shall not be placed on the market. The safety and acceptability of food is of critical importance. Consumers must have confidence and assurance that the food they buy will be what they expect and will do them no harm or have an adverse effect. The aim of Article 14 is to protect the consumer from food that is either a health risk or unacceptable. The mentioned article defines the general food safety requirements which are used with the risk management requirements covered by Article 19 to reduce or eliminate any risk due to the placing of unsafe foods on the market. The definition of 'placing on the market' is quite wide and it includes all sales and supplies, including one-off sales, one-off supplies free of charge, and holding food for the purpose of sale. The Article does not, however, cover primary production for private domestic use, or the use of food for private domestic consumption, which are exempted by the Regulation No 178/2002.

The free movement of safe and wholesome food is an essential aspect of the internal market and contributes significantly to the health and well-being of citizens, and to their social and economic interests (recital 1 of Reg. No 178/2002). Thus it was necessary to adopt measures aimed at guaranteeing that unsafe food is not placed on the market and at ensuring that systems exist to identify and respond to food safety problems in order to ensure the proper functioning of the internal market. Similar issues relating to feed safety are addressed. Beside the general EU's rules,

some member states have adopted horizontal legislation on food safety imposing, in particular, a general obligation on economic operators to market only food that is safe.

For example, Polish definition of food safety differs from the EU's. On the basis of Article No 3 of Act of August 25 th 2006 - Food and Feed Safety⁵, the food safety must be understood as the general conditions which have to be met and considered, such as: food additives, contaminations, remains of pesticides, irradiate conditions, organoleptic features and all activities that should be undertaken on all production's stages. Their aim is to assure humans wellness.

However, member states apply different basic criteria for establishing whether a food is safe. Given these different approaches, and in the absence of horizontal legislation in other member states, barriers to trade in foods are liable to arise. Similarly such barriers may arise to trade in feed. Therefore it is necessary to establish general requirements for only safe food and feed to be placed on the market, to ensure that the internal market in such products functions effectively on the basis of production contracts.

The food safety has also the economic dimension. It considers the food security as a matter of raw materials supply and is tied to one of the contracts' functions. The production contract is strictly related with two production stages – the production and delivery of the agricultural product. The contract secures the volume of production specified in the contract. For the agricultural producer it is a guarantee of the possibility to make a previously agreed amount of products, e.g. according to the mass or yield from a particular area. Thus, the farmer has a guarantee of the market and payment for the products.

As food safety and the food security, in the final market depend on several stages of the supply chain. Some kind of vertical coordination is necessary in order to assure compliance with regulations and to avoid potentially negative demand effects. Vertical coordination refers to the synchronization of successive stages of production and marketing, with respect to quantity, quality, and timing of product flows (Arzu et al., 2006). That is why coordination is achieved by written contracts regulating the relationship between farmers and contractors.

The use of formalized written contracts concluded in advance of production and delivery containing basic elements is not widespread. It is vivid on selected markets, like sugar, fruits and vegetables, swine, rapes, etc. It always takes a place wherever it is necessary to secure a certain volume of production. But it might be the best way to assure the quality standards. It guarantees that the agricultural producer will supply agricultural products of the required not only quantity but also quality. It is not only a matter of achieving the desirable parameters of the supplied raw material, but also a matter of production from the input material indicated by the contracting authority, usually according to their cultivation recommendations (Lipi ska, 2013).

Contracts play a huge role in a production chain, because they not only ensure quality but they guarantee some other product specifications. Quality incentives for some players along the vertical chain often are needed. On a basis of the contracts the new technology (e.g., specialized inputs, buildings) might be transferred by processors to farmers. The same time they may casted their use, otherwise the contractor might cancel the goods collection as well as terminate the contract on farmer's fault.

However there great disparity might be seen in bargaining power and marketing information between contractor (e.g., processors or integrators) and farmers. Thus EU's policy makers have responded with Regulation (EU) No 261/2012 of the European Parliament and of the Council of 14 March 2012 amending Council Regulation (EC) No 1234/2007 as regards contractual relations in the milk and milk products sector (O.J. UE L 94, p. 38-48). The legislation regulates only selected agricultural contracts, but it might be the milestone in covering other agricultural markets and sectors. In this case, among the basic conditions, it is important that the price payable for the delivery can be set in the contract, at the choice of the contracting parties, as a static price or a price

⁵O.J. 2010, No 136, 914 with subsequent amendments.

varying depending on defined factors. For example, on the basis of Article No Point 7 Council Regulation No 261/2012 the price for milk shall be depended on the volume and the quality or composition of the raw milk delivered.

In the absence of Union legislation concerning production contracts, the legislator expressed that member states may, within their own contract law systems, decide to make the use of such contracts compulsory provided that in doing so Union law is respected and in particular that the proper functioning of the internal market and the common market organization is respected. In view of the diversity of the situations that exist across the Union in relation to contract law, in the interests of subsidiarity, such a decision should remain with Member States⁶.

In the environment of industrialized and modern agriculture setting the legal model of production contract is like a puzzle for lawmakers and regulators (Wu, 2003). On the one hand, the greater coordination of the food system through such contracts and integration has efficiency, equitability, and power effects. On the other hand, the increased concentration of large processors is eroding the economic power of small growers, raising questions about the equitability of contract arrangements, and expanding the potential for fraud and other dishonest behavior. And no one should forget that that agricultural food safety involves the primary production and processing of raw agricultural products, and it starts from the very beginning of food supply chain.

In order to ensure appropriate minimum standards for such contracts and to ensure that the internal market and the common market organization function well according to the food safety, some basic conditions for the use of such contracts should be laid down at least domestic and even Union level. All such basic conditions should, however, be freely negotiated. One of its example is vivid in Polish Civil Code and French Code Rural (Code,2013).

The new agricultural economy is characterized by two main overriding features, such as greater concentration (intensity) of farms into smaller numbers with large sizes and rising influence of contract farming, and the evolution of integrated supply chains linking producers and consumers (Opara, 2003). Such intensive agriculture relies heavily on irrigation, agro-chemicals, use of new technologies, and basic raw materials that possess new traits such as genetically modified plants and animals. Under the new agricultural economy, these attributes of intensive farming create new challenges for sustainable production and processing practices that promote a balanced approach to the problems of food quality, safety, and good environmental stewardship. The shift from quantity-oriented agriculture to new emphasis on quality, safety, functionality and sustainability, have placed new demands for the development and adoption of traceable supply chains. Besides contract farming more often implies shorter, direct chains between farmers and companies. This is often essential for traceability and quality upgrading.

In order to ensure large and consistent volumes of high-quality and safe produce, food processors procure from preferred suppliers, on a production contract basis, and thereby push the food distribution system towards more and more vertical integration. Some of them are large scale, and let to increase the scope for standardized production and for meeting high standards at low transaction costs (Maertens &, Swinnen, 2008). Moreover, well-specified contracts include farm extension and assistance programs that can alleviate the financial and technical constraints small farmers in meeting increasingly stringent standards.

Agricultural production and investments always involve risk. Thus one of the main functions of the production contract should be protection of agricultural producers from unfavorable consequences which may appear during the execution of the contract. Agricultural activity is considerably exposed to the risk of external factors, which are usually beyond the farmer's control and which cannot be prevented. This concerns unpredictable natural factors. The most likely reasons for the failure are poor crop management, natural calamities, pest epidemics, market collapse and price fluctuations. The cultivation contract gives a possibility to share the risk of production according to

⁶ See point No. 9 of Regulation 261/2012.

the shared. The aforementioned negative external factors determine the yield volume and influence the price level on the market. By signing a cultivation contract the agricultural producer cannot prevent them directly, but the farmer has a possibility to receive the agreed price regardless of the turmoil on the market. The standard agribusiness approach to indemnify against quantity shortfalls is crop insurance. Its obligation might be one of the production contract provisions. As the farming involved in a contract arrangement becomes technologically more advanced, the range of risks to which it is subject generally becomes more expensive. But in some way this is a “production” risk, that farmer may incur without the proper farm management.

Conclusion

The production contract regulations are likely to impact the value chain from the farm gate to the consumer through the range and prices of “safe” foods products.

The production contracts may help to reinforce the responsibility of operators in the food chain and increase awareness of the need to better take into account the signals of the market, to improve price transmission and to adapt supply to demand, as well as to help to avoid certain unfair commercial practices.

Contract production may improve the efficiency of the agricultural system and allow a clearer transmission of consumer preferences, and spawned new value-added products for consumers.

From an economics point of view, regulations are intended to correct market failures and/or reduce transaction costs of market participants, as well as assure the food safety.

Contracting is important because it can provide alternative governance mechanisms for the agricultural sector and can often improve the efficiency of supply chains. Improvements can be attributed to an altering of incentives for market participants, to greater co-ordination between the different stages of the chain, as well as managing product quality.

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