Authors
Arthur Blouin
University of Toronto

Rocco Macchiavello
London School of Economics and Political Science


STRATEGIC DEFAULT IN THE INTERNATIONAL COFFEE MARKET*

Arthur Blouin Rocco Macchiavello

December 14, 2018

This paper studies strategic default on forward sale contracts in the international coffee market. To test for strategic default, we construct contract-specific measures of unanticipated changes in market conditions by comparing spot prices at maturity with the relevant futures prices at the contracting date. Unanticipated rises in market prices increase defaults on fixed price contracts but not on price-indexed ones. We isolate strategic default by focusing on unanticipated rises at the time of delivery after production decisions are sunk and suppliers have been paid. Estimates suggest that roughly half of the observed defaults are strategic. We model how strategic default introduces a trade-off between insurance and counterparty risk: relative to indexed contracts, fixed-price contracts insure against price swings but create incentives to default when market conditions change. A model calibration suggests that the possibility of strategic default causes 15.8% average losses in output, significant dispersion in the marginal product of capital and sizeable negative externalities on supplying farmers. **JEL Codes**: D22, L14, G32, O16.

Keywords: Strategic Default, Contractual Forms, Counterparty Risk.

*We are grateful to the Editors, Pol Antras and Andrei Shleifer, and to four anonymous referees. Also to David Atkin, Abhijit Banerjee, Sascha Becker, Jordi Blanes-i-Vidal, Lorenzo Casaburi, Marcel Fafchamps, Bob Gibbons, Amit Khandelwal, Claudio Michelacci, Dilip Mookherjee, Sharun Mukand, Andy Newman, Elias Papaioannou, Daniel Paravisini, Adriano Rampini, Debraj Ray, Antoinette Schoar, Catherine Thomas and numerous people working at the institution that has shared the data used in this paper for many comments and suggestions. We also thank seminar and workshop participants in ASSA, Bank of Italy, Berkeley, Berkeley ARE, BU, Columbia, Cost, Delhi, EIEF, ESSFM, Gremaq, INSEAD, IPA, Kellogg, Leicester, Manchester, MIT Sloan, Munich, NBER/BREAD, NEUDC, Oslo, Oxford, PSE, UCSD, USC, SSE, Stanford, UCLA, UPF, Warwick. Matteo Bonetton, Niclas Moneke, Juan Morales and Caroline Nicol provided outstanding research assistance. We gratefully acknowledge IGC and IPA financial support. Correspondence Address: Rocco Macchiavello, Department of Management, London School of Economics and Political Science, Houghton Street, London, WC2A 2AE United Kingdom, r.macchiavello@lse.ac.uk

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