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STRATEGIC DEFAULT IN THE

INTERNATIONAL COFFEE MARKET*

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December 14, 2018

Strategic Default in the International Coffee Market

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 priceindexed 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.

December 14, 2018