Competition on Agricultural Markets and Quality of Smallholder Supply: The Role of Relational Contracting and Input Provision by Traders

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April 2024

Abstract

We analyze how market power by traders on local agricultural spot markets affects investment in crop quality by smallholders in a context with "imperfect institutions"—without third-party contract enforcement and with incomplete input markets. Farmers and traders can engage in relational contracting where the promise of future rents supports current cooperation. We analyze informal contracting under the shadow of side selling by the farmer and ask how changes in the competitiveness of local markets affect flows of inputs in relational contracts. When local markets become more competitive, fewer farmers are included in relational contracting with traders, and farmers who remain in such relationships receive less support from traders. We document empirical evidence from local wheat markets in Ethiopia that is consistent with the theory.

Keywords: market power, agricultural markets, technology transfer, quality investment, trader.

JEL Codes: C13, C7, D4, D6, I3, L1, O1.

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We thank two anonymous reviewers for helpful comments and suggestions that helped us to improve the manuscript. This research was supported by the French National Research Agency (ANR), the IPORA large research program, the CGIAR Research Program on Policies, Markets, and Institutions (PIM), as part of their flagship program on Inclusive and Efficient Value Chains, and by J-PAL and CEGA's Agricultural Technology Adoption Initiative (ATAI). The study received IRB approval from the University of California Berkeley (study number 20192938). Any errors are the sole responsibility of the author.

1. Introduction

The idea that competitive markets foster innovation and promote growth and welfare is one of the maxims of economics.[1] Through selection and incentive effects, competition causes productivity growth, raises quality, and lowers prices for downstream agents in the value chain in the long run. However, this belief rests on the assumption that markets are embedded in a context of “good institutions”, where trading agents have access to low-cost mechanisms of third-party contract enforcement. In weakly institutionalized contexts, which prevail in rural areas in many low-income countries, it is not evident that economic performance improves as markets become more competitive. We analyze this issue using the case of smallholder production in Africa as a motivating example.

The modernization of smallholder farming is an important component of most strategies to reduce rural poverty in agriculture-based economies. However, modernization and intensification of smallholder farming are impeded by narrow profit margins that curb incentives to “invest" in quality-enhancing inputs. Imperfect competition on local commodity markets is commonly seen as a factor contributing to small margins for producers (e.g., Bartkus et al., 2022). If the benefits of investments in quality-enhancing inputs and practices are “creamed off ” by traders with market power, then farmers may respond by supplying low-quality output.[2] A common concern is that low product quality limits access to high-value supply chains and could lock rural producers into poverty.

This paper uses theory to explore the complex relationship between the intensity of competition on local agricultural markets and the quality of smallholder supply. Complementing the perspective that imperfect competition lowers crop prices and erodes incentives for quality production, we propose that market power by traders fosters relational contracting in contexts with imperfect rural factor markets and poor contract-enforcement institutions. Trader market power on local spot markets makes spot-market trading less attractive for farmers. Constraints for relational contracting are relaxed as the risk of side selling is atten-

[1] An exception to this rule is that market power may create rents that enable firms to implement research and development efforts that support innovation (e.g., Aghion et al., 2005).

[2] Smallholders respond strongly to market incentives when deciding about the appropriate quality level of their supply. For example, bulking and mixing of smallholder supply at the local level, before grading occurs, creates a well-known lemons problem because farmers are paid on the basis of average quality rather than the quality of their supply. This attenuates incentives to supply high-quality output. Research in the horticulture, dairy, and cereal sectors suggests this problem can be effectively countered by certification of individual supply (Anissa et al., 2021; Bernard et al., 2017; Saenger et al., 2014; Treurniet, 2021).

uated—stimulating technology transfer.[3] In our model, traders supply quality-enhancing inputs to liquidity-constrained smallholders who otherwise cannot access these. Equilibrium strategies are analyzed to study how competition between traders affects cooperation between traders and farmers and the resulting quality of agricultural output. The main conclusion is that promoting competition between traders on spot markets (i) leaves the quality of output provided by "spot-market farmers" unaffected, (ii) reduces the quality of output provided by farmers in a relational contract with a trader, and (iii) reduces the share of farmers in such a relationship.

The contribution of this paper is threefold. First, we highlight the interdependency between relational contracting and traditional spot markets in an environment where input markets are incomplete and formal contracts cannot be enforced. Second, we study how the intensity of competition on local spot markets affects both the extensive and intensive margin of relational contracting: Which farmers are included in relationships, and how much support do they receive from traders? Therefore, this paper contributes to the thin literature on value-chain development and technology transfer. Third, we use observational data from wheat markets in Ethiopia to explore whether theoretical predictions are consistent with facts.

The paper is organized as follows. In section 2, we discuss the existing literature on competition between traders and the quality of agricultural produce when (formal) contracting opportunities and factor markets are imperfect. In section 3, we introduce our model of relational contracting on agricultural markets—focusing on the risk of holdup by the farmer. We ask how competition on spot markets affects the selection of farmers for relational contracting and shapes the informal contracts that can be negotiated. Finally, in section 4, we present data for a sample of Ethiopian wheat markets and demonstrate that key model predictions are consistent with observations.

2. Competition and crop quality wheat market

Imperfect competition can be sustained if there are natural or man-made barriers to entry in the intermediated trade sector, which is easy to imagine in the context of remote and

[3]Smallholders may engage in contracting for several reasons, including improved risk management, reduced transaction costs, a guaranteed market outlet, or obtaining credit. We focus on access to quality-enhancing inputs.

thinly populated areas.[4] What evidence exists for the belief that traders have "market power" and earn supernormal profits? Unobserved trader cost and services complicate assessment of this issue, and the available evidence is rather scant and appears mixed. Dillon and Dambro (2017) review the evidence for African crop markets and conclude that these markets are fairly competitive.[5] This follows fromanalyses based on commodity prices and trader profits, market concentration ratios, and barriers to entry and exit on market. However, more recent experimental studies provide a more mixed picture. While Casaburi and Reed (2022) find evidence of pass-through of subsidies provided to cocoa traders in Sierra Leone (in the formof relaxed credit constraints for farmers—an example of interlinked transactions), Bergquist and Dinerstein (2020) document that maize markets in Kenya are not competitive. Windfall benefits are incompletely passed through to producers, and traders collude to retain the bulk of the surplus created through trade. A careful nonexperimental study highlights the importance of search costs as a determinant of imperfect competition between traders (Casaburi et al., 2013).

The intensity of competition in rural markets remains a contested issue, and there is also little agreement about its effects.[6] Generally speaking, economists believe that "an increase in competition on one side of the market is beneficial for agents on the other side of the market" (Swinnen and Vandeplas, 2015). Ample evidence is consistent with this insight, also from low-income countries (Busso and Galiani, 2019; Jensen and Miller, 2018). In the context of simple spot-market trading between farmers and traders, analyzed below, more competition between traders might increase the share of the crop's value accruing to the farmer. However, the welfare effects of more intense competition vary with the institutional context, particularly with the contract environment.

Imagine a context with imperfect factors and input markets. Smallholders are liquidity constrained because of lack of access to formal credit and unable to purchase quality-enhancing inputs (e.g., see Dillon and Barrett, 2017). Traders purchasing output from

[4]For example, Kopp and Brümmer (2017) find that remoteness and market size are determinants of trader market power in the context of the Indonesian rubber trade. Other factors conducive to the persistence of trader market power are fixed entry costs (Bartkus et al., 2022), interlocking credit and output markets (e.g., Kopp and Brümmer, 2017; Subramanian and Qaim, 2011), crop perishability (Singh, 2002), lock-in investments by farmers (Russo et al., 2011), or large-scale contract farming (e.g., Sivramkrishna and Jyotishi, 2008.

[5]See, e.g., Fafchamps (2004) and Osborne (2005) for more details.

[6]The potential effects of market power are complex and many, even in contexts with good enforcement institutions. For example, Swinnen et al. (2010) mention possible efficiency gains due to (i) scale economies, (ii) reduced transaction costs, or (iii) extra investments in productivity enhancing research, development, and innovation. In addition, (iv) conditions elsewhere in the value chain are important (e.g., is concentration necessary to wield countervailing power?), and (v) under specific conditions an increase in market power may reduce opportunities for collusion by agents in that particular node of the chain.

smallholders can provide inputs in kind, or provide cash to the farmer, where the value of the (in-kind) loan is later deducted from the payment that farmers receive upon delivery.[7] If third-party enforcement of agreements is not feasible, informal agreement should be self-enforcing (e.g., Ghosh and Ray, 1996). The promise of future rents from cooperation should prevent contracting parties from reneging today and pursuing short-term gains (Fafchamps, 2004; Kuijpers and Swinnen, 2016; Swinnen and Vandeplas, 2015; Swinnen et al., 2010). An interesting insight is that imperfect competition between traders can help resolve contract-enforcement and technology-transfer problems. Without third-party enforcement, agreements are vulnerable to holdup issues, default, renegotiation, diversion, or side selling (e.g., Upton and Lentz, 2017). In such a second-best context, market power by traders implies that farmers cannot easily renege by turning to the spot market. This fosters cooperation—creating scope for efficiency gains.[8]

There exists little empirical work on the relation between competition and quality in the context of weakly institutionalized agricultural markets.[9] We are aware of two papers dealing with these issues. First, Ghani and Reed (2022) study the relationship between fishermen and retailers when the latter provide an intermediate input (ice) to the former. By prioritizing preferred fishermen when ice is scarce, retailers use the supply of ice to help maintain customer loyalty and support relational contracting. Ghani and Reed (2022) show that the entry of new ice suppliers facilitates switching between fishermen and retailers. Competition between retailers changes the nature of the agreements between retailers and fishermen (customer loyalty is bought through the provision of credit rather than ice), which improves fishermen's productivity and raises welfare. Macchiavello and Morjaria (2021) find that introducing competition has adverse effects. They study relational contracting between coffee growers and a monopsonistic miller. Entry by a competing mill lowers the quantity and quality of beans supplied by smallholder farmers. Competition makes relational contracting more difficult by facilitating side selling by farmers.

[7]Traders charge interest for such loans, either a positive interest rate for loans in cash or an inflated price discount upon delivery for in-kind loans. In our model, we abstract from interest, but see Kopp and Brümmer (2017) for interest rates and "strategic indebtment" of smallholders by traders—an alternative channel via which traders can ensure market power in specific trading relationships.

[8]The so-called "modern agricultural market" paradigm explores similar issues in the context of imperfectly competitive US agricultural markets with large-scale processors (Sexton, 2013).

[9]larger literature explores other issues related to relational contracting in agriculture. Levin (2003) shows that relational incentive contracts are stationary even in the presence of asymmetric information about the other agent's type (adverse selection) or behavior (moral hazard). Macchiavello and Morjaria (2015) introduce learning about the other agent's type and find that relational contracts can be nonstationary. Casaburi and Reed (2022) study infrequent payments as a savings commitment device for dairy farmers with time-inconsistent preferences. The ability to supply this service depends on the milk buyer's incentive to renege

Competition increases the risk for mills to invest in the provision of complementary inputs and services—reducing overall productivity and performance.

Our work extends existing theory. We explicitly analyze both the extensive and intensive margins of relational contracting—exploring the extent to which relational contracts are inclusive and efficient. We also explicitly link relational contracting to a model of trading on spot markets. Macchiavello and Morjaria (2021) study the effects of entry by a competing coffee mill, which is assumed to raise the (exogenous) coffee price that farmers may obtain elsewhere. This increases the minimum price that the incumbent should pay to avoid side selling by the farmer. Instead, in our model traders and farmers can meet on the spot market or engage in a relationship, prices are determined endogenously, and competition affects the returns to either marketing channel. Surplus creation and distribution are a function of the intensity of local competition between traders through the interaction of the two trading regimes.[10]

3. A model of relational contracting

Below we present amodel of relational contracting by a farmer and a trader. First, however, on the basis of Cournot competition between traders on the local spot market, we describe the default outcome for farmers and traders who are not in a relationship—a model of Cournot oligopsony. On spot market j there are M_j traders.[11] Consider a model where the farmer produces a unit of output and can improve the quality of that unit by allocating (additional) effort e to production or handling (e.g., storage). This involves a cost $c(e)$ for the farmer. If farmer i is unable to sell his unit to the trader, he consumes it himself, generating a default value v, which is independent of quality.[12] We assume farmers may carry their output to the local market and incur a per unit transport cost of λ. Define the travel distance from farmer i to the nearest local market as di and assume that d is uniformly distributed across the range $[d^* - w, d^* + w]$, where d^* and w are parameters.

[10] Swinnen et al. (2010) and Swinnen and Vandeplas (2015) also do not model competition between traders explicitly. They assume that informal contracts are supported by a reputation cost in case the party reneges (a parameter). This model is tied together by assumptions about how competition affects reputation costs.

[11] For simplicity, we treat the number of traders as given. For models with free entry in the trading sector and an endogenous number of traders, refer to, e.g., Antras and Costinot (2011) or Krishna and Sheveleva (2017a).

[12] For example, the farmer only cares about the nutritional value or taste of his crop and not about its color, shape, or size. Processors may care about the distribution of the size of individual kernels, something that is less important for the farming household. In addition, the extraction rate is a quality attribute that is relevant for processors (e.g., in relation to drying costs) but much less so for farmers.

The sum of effort, opportunity, and travel costs for farmer i is equal to $c(e)+v+d_i\lambda$, where the farmer chooses effort level e optimally (see below).

If output is sold, the trader transports it at fixed cost τ to a processor or consumers in an urban center. The unit price on the final market equals $P(e)$, reflecting quality differentials due to farmer effort; $P' > 0, P'' < 0$. We assume that there are gains from trading, at least for a subset of farmers located sufficiently close to the market, or that $P(e)-\tau > c(e)+v+(d^*-w)\lambda$.

3.1. Spot-Market Trading

Farmers and traders meet on a local spot market. Motivated by the Ethiopian wheat market example explored below, we assume farmers use donkey carts, motorcycle taxis, or other high-cost transport technologies to visit the local market and bring a unit of their crop. This is sold to one of the (identical) traders present. Among other factors, the intensity of competition between traders determines the unit price p paid to farmers. Farmer i will engage in trading only if her returns are positive, or when $p > c(e)+v+d_i\lambda$. This defines an extensive margin for spot market trading, which generates an upward-sloping supply curve because only the subset of

$$F(.) = \frac{(p-c(e)-v/\lambda)(d^*-w)}{2w}$$

will engage in trade (where F is the cumulative density function of the uniform distribution).

We consider symmetric equilibria where all traders behave the same. Traders decide how much grain to buy, q, given other traders' quantities. Aggregate quantity $Q = \sum_M q$ enters the traders' profit function through the inverse supply curve

$$p = \frac{2wQ+(d^*-w)}{\lambda} + v + c(e) \tag{1}$$

and each trader maximizes the following profit function:

$$\pi_T = (P(e)-\tau-p)q \tag{2}$$

The solution of 2 gives us the optimal quantity of crop bought by each trader,

$$\hat{q} = \frac{(P(e) - \tau - v - c(e))\lambda - (d^* - w)}{2w} - \sum q \tag{3}$$

so that in a symmetric equilibrium,

$$\hat{q} = \frac{(P(e) - \tau - v - c(e))\lambda - (d^* - w)}{2w(1 + M)} \tag{4}$$

Substituting in 1 gives us an expression for the equilibrium Cournot price, p^c:

$$p^c = \frac{M(P(e) - \tau) + (d^* - w)/\lambda + v + c(e)}{1 + M} \tag{5}$$

Three insights follow fromthis stylized model. First, if local agricultural markets become more competitive (or, as the number of traders increases), then prices paid to smallholders increase; $\partial p^c / \partial M > 0$. Second, the farmer chooses an efficient quality level for the output she produces and trades, and this quality level is independent of the intensity of competition between traders. Farmers selling their output choose effort to maximize the following objective function:

$$\pi_{F,i} = \frac{M(P(e) - \tau) + (d^* - w)/\lambda + v + c(e)}{1 + M} - d_i \lambda - c(e) \tag{6}$$

Denote the farmer's optimal effort level by $\hat{e}$, which is implicitly defined by $P' = c'$ (so that $\partial e / \partial M = 0$).While traders offer higher prices if competition is more intense, the pass-through of the premium is complete and correctly incentivizes the farmer to invest in quality. Observe that this is an artifact of the Cournot oligopsony model—underinvestment in quality may occur for alternative specifications of the process describing how the surplus is distributed between the farmer and the trader.[13]

Third, observe that farmer travel cost to the nearest market determines whether or not she would engage in spot-market trading.Define $\hat{d}$ as the critical distance where the farmer is indifferent between trading on the market (and obtain $\pi_{F,i}(\hat{d})$ as defined in [6]) and consuming the crop herself (and obtain v). Farmers "far away from spot markets" (i.e., with $d_i > \hat{d}$) will not trade on spot markets, and farmers living sufficiently close to markets

[13] If, instead, we assume bilateral bargaining over the surplus between trader and farmer, then part of the surplus accrues to the trader, and the farmer invests too little in improvement of crop quality. A more competitive market (where farmers have greater bargaining power) then implies that farmers obtain a greater share of the crop's value. This means investments in quality are increasing in the number of traders. Hence, the finding that competition between traders does not affect the quality of spot-market production is an artifact of the assumption of Cournot competition.

($d_i < \hat{d}$) will trade. In what follows we focus on the latter type of farmers.

With Cournot competition, income for farmer i and traders is as follows:

$$\pi^C_{F,i} = \frac{M(P(\hat{e}) - \tau - c(\hat{e})) + (d^* - w)/\lambda + \nu}{1+M} - d_i\lambda \tag{7a}$$

$$\pi^C_T = P(\hat{e}) - \tau - \frac{M(P(\hat{e}) - \tau) + (d^* - w)/\lambda + \nu + c(\hat{e})}{1+M} \tag{7b}$$

Not surprisingly, more intense trader competition increases farmer income $\partial \pi^C_F = \partial M > 0$ and reduces trader income $\partial \pi^C_T = \partial M < 0$.

3.2. Relational Contracting

The Cournot oligopsony model rests on the assumption that farmers and traders meet on the local market and engage in one-time trading.However, as discussed above, outcomes may improve if farmers and traders play a repeated game. In what follows, we consider the case where traders can visit farmers on their farms before the growing season, engage in farm-gate bargaining, and offer an agreement to start sustained cooperation. Some farmers are not selected for relational contracting (see below), and traders compete Cournot-style for the output of these excluded farmers on the various spot markets after the growing season.

We assume a farmer can be visited by only one trader—for example, the one with lowest social-distance costs (e.g., kinship links or coethnicity; affecting communication and trust and, hence, "contacting and contracting" costs).[14] The reason may be that social distance is public information, so that other traders know that they are unlikely to outbid the lowest-cost trader. They are therefore unwilling to travel to the farm. Such a matching process relies on trader heterogeneity that is easily included in the model. For example, we introduce exogenous and farmer specific "matching costs" for farmer i and trader k: D_{ik}. If selected at all, farmer i is visited by trader k with the lowest realization of D_{ik}.

[14]The assumption that farmers receive one relational contracting offer implies that farmers who reject the contract (or who break it—see below) will have to trade on the local spot market. It also implies that traders can ignore the risk of potential "relational contracting" offers by other traders. Introducing such competition between traders to engage in a relationship implies introducing another constraint that the trader would have to respect when proposing a relational contract (the value to the farmer of the "next best" contract proposed by the trader with the next-lowest transaction costs).

Assume crop quality can be improved if the farmer uses an additional input provided by the trader. This input is not available to the farmer himself, perhaps due to an imperfection on the capitalmarket—farmers cannot obtain credit and are liquidity constrained.[15] We also assume that formal contracting institutions, supported by third-party enforcement, are excessively expensive. This could be due to fixed costs associated with formal verification and judication (combined with small traded volumes) or because some relevant margins are unobservable to outsiders. As a result, traders and farmers have to negotiate informal contracts that are subgame perfect and do not require outside enforcement.Cooperation is supported by the threat of breaking up the relation in case of defection by one of the partners, so that future rents of cooperation are lost.We also assume that information about farmers reneging on a relational contract is "public" (i.e., either perfect observability of trading behavior or full information sharing between traders), so that cheating one trader automatically implies foregoing all opportunities of future cooperation—the reneging farmer is permanently relegated to the spot market.[16] Both agents choose a grim trigger strategy of punishment.

Denote the quantity of the complementary input offered by the trader to the farmer by z. The trader also chooses the level of effort that the farmer has to supply. For simplicity, assume that the complementary input does not affect the marginal return to labor, and that the trader chooses effort level $e = \hat{e}$ (which she is able to verify—i.e., no asymmetric information).[17] The crop's price on the final market is $P(z; \hat{e})$;, with $P_z > 0$, $P_{zz} < 0$. Consider the case where the trader seeks to write a profit-maximizing contract that includes z units of the complementary input. When considering a relational contract for farmer i, trader k's objective function reads

$$\max_z P(z; \hat{e}) - \tau - \gamma z - \rho_i - D_{ik} \tag{8}$$

where γ is the unit cost of the input, ρ_i is the compensation offered to farmer i, and other

[15] Alternatively, they may find it difficult to save capital for purchasing inputs (Duflo et al., 2011). Traders instead have easier access to capital and may have lower transaction costs due to economies of scale or access to better information.

[16] We assume coordinating on joint punishment of cheating farmers is incentive compatible for traders. This may be because reneging today is a strong signal of the propensity to renege again tomorrow (i.e., the farmer is revealed to be of a "bad type"). Alternatively, traders may form a coalition that engages in second-order punishment of traders who engage with the "wrong farmer" (e.g., ostracism, expulsion from the club, reputation cost—see Aoki, 2001). Greif (1993) discusses another mechanism why fully informed traders may refuse to engage with farmers who cheated in the past. His mechanism is driven by expectations about the probability of the farmer being invited to be in future relationships, which determines the payment that should be offered today to keep the farmer behaving honestly.

[17] See Levin (2003) for models of relational contracting with adverse selection or moral hazard.

parameters are as defined above.[18] The trader has to consider two participation constraints, for the farmer and himself. Respectively

$$\rho_i - c(\hat{e}) \geq \pi^C_{F,i} \tag{9a}$$

$$P(z;\hat{e}) - \tau - \gamma z - \rho_i - D_{ik} \geq \pi^C_T \tag{9b}$$

In addition, an incentive compatibility constraint for farmers is relevant. The new input raises the crop's value and creates an incentive for farmer i to renege on the relational contract and side sell his valuable crop on the spot market instead. The farmer's incentive compatibility constraint reads as follows:

$$\{\frac{M(P(z;\hat{e}) - \tau) + (d^* - w)/\lambda + v + c(\hat{e})}{1+M} - d_i\lambda - c(\hat{e})\} + \frac{(1-r)\Pi^C_{F,i}}{r} \leq \frac{\rho_i - c(\hat{e})}{r} \tag{10}$$

Condition (10) spells out that summing the net profit of one-time reneging (side selling, as captured by the term in curly brackets on the left-hand side) and the present value of the flow of spot-market trading in all future periods (the second term on the left-hand side) should not exceed the present value of relational contracting (the right-hand side). In (10), r is the (common) discount rate, representing the farmer's (and trader's) level of patience. We rewrite (10) as

$$\rho_i \geq \Pi^C_{F,i} + c(\hat{e}) + \frac{rM}{1+M}\{P(z;\hat{e}) - P(\hat{e})\} \tag{11}$$

The trader should provide a payment that compensates the farmer for foregone income and effort cost (the first two terms on the right-hand side of [11]) and includes an efficiency premium. In a relationship, farmers earn more than they do on the spot market. The efficiency premium is needed to prevent side selling of the high-value crop and effectively implies a form of profit sharing between trader and farmer.

Observe that the efficiency premium decreases as the farmer is more patient and approaches zero as $r \to 0$. In contrast, when the farmer is infinitely impatient ($r \to 1$), the efficiency premium approaches the complete price premium. Condition (11) is more

[18] Observe that trader travel cost, τ, does not vary across farmers. This may be due to the fact that, compared with farmers, they have access to a low-cost transportation technology (such as a pickup truck) so that small differences in local procurement cost are small and can be ignored.

stringent than (9a), so the latter can be omitted. Assume that for the trader's optimal solution, (11) holds as an equality—the trader pays the lowest possible price to the farmer.

There is no risk of reneging by the trader (it is easy to verify that the trader's incentive constraint is less stringent than her participation constraint), so trader k's problem with respect to the choice of the optimal input level is given by

$$\max_z P(z;\hat{e}) - \tau - \gamma z - \Pi^C_{F,i} - c(\hat{e}) - D_{ik} - \frac{rM}{1+M}\{P(z;\hat{e}) - P(\hat{e})\} \tag{12}$$

subject to constraint (9b).

We now solve for extensive and intensive margins of relational contracts: Who is offered a contract, and what does the contract look like? We start with the latter question.

3.2.1. Competition and the intensive margin

Consider an existing trader-farmer match, where the trader's participation constraint is not binding. The trader chooses the optimal level of input provision, z^*, by taking first derivatives of the profit function. Input provision is implicitly defined by the following equality:

$$P_z = \gamma \frac{1+M}{1+M-rM} > \gamma \tag{13}$$

In words, the marginal benefit of input provision should equal the marginal cost, or the sum of the input cost augmented by the increment of the efficiency premium. In equilibrium, the trader under supplies inputs relative to the socially optimal outcome as the efficiency premium acts as a "trader tax" on the generation of value. Differentiation of (13) yields

$$\frac{\partial z}{\partial M} = \frac{r\gamma}{P_{zz}(1+M-rM)^2} < 0 \tag{14}$$

More competition on agricultural markets induces traders to supply smaller quantities of the quality-enhancing input. If traders have less market power

on the spot market, prices on the spot market are higher, so the returns to side selling for farmers go up. This tightens the farmer's incentive compatibility constraint, and smaller quantities of z can be provided. Farmers produce output of lower quality and less value.

Prediction 1. More intense competition between traders on local spot markets shifts the intensive margin of relational contracting inward. Traders provide smaller quantities of quality-enhancing inputs to farmers, which lowers the quality of the crop produced by farmers in an informal relationship.

3.2.2. Competition and the extensive margin

Traders cannot engage in relational contracting with every farmer. Farmers are heterogeneous in terms of their distance to the spot market, d_i, and hence differ in terms of their costs of accessing the spot market. Traders can only engage in a relationship with farmers living far away from local spot markets ($d_i > \tilde{d}$), because these farmers will not renege on their contracts. Hence, more valuable contracts can be negotiated. The trader's participation constraint (9b) defines the "critical farmer" with whom the trader can have a relational contract. Substituting (7a-7b) and (11) in (9b) and solving as an equality yields the extensive margin of contracting:

$$d_i = \tilde{d} = \frac{1}{\lambda}[\gamma z + D_{ik} + \frac{(rM - 1 - M)}{1+M}(P(z;\hat{e}) - P(\hat{e}))] \tag{15}$$

All farmers with $d_i \leq \tilde{d}$ have high potential earnings on the spot market and cannot engage in relational contracting. How does the extensive margin shift as new traders enter the spot market? After some manipulation, and using first order condition (13), it can be shown that the threshold value shifts out if local markets become more competitive:

$$\frac{\partial \tilde{d}}{\partial M} = \frac{1}{\lambda}[\gamma \frac{\partial z}{\partial M} + (\frac{rM - 1 - M}{1+M})P_z \frac{\partial z}{\partial M} + \frac{r}{(1+M)^2}(P(z;\hat{e}) - P(\hat{e}))] = \frac{r}{\lambda(1+M)^2}(P(z;\hat{e}) - P(\hat{e})) > 0 \tag{16}$$

This means relational contracting becomes less inclusive—fewer farmers qualify for a relationship with a trader. The reason, again, is that the incentive compatibility constraint becomes more binding as local spot-market prices increase.

Proposition 2. More intense competition between traders on local spot markets shifts the extensive margin of relational contracting inward. Traders provide inputs to fewer farmers, which lowers the quality of the crop produced by farmers who lose their informal relationship.

What happens after (policy) interventions make local markets more "competitive," for example by issuing a larger number of permits to traders or by investing in infrastructure to reduce trader transport costs? The model predicts that this will reduce average crop quality: (i) while it does not affect crop quality produced by spot-market farmers ($\partial \hat{e}/\partial M = 0$), (ii) it reduces crop quality produced by farmers losing their relationship with a trader ($\partial \tilde{d}/\partial M > 0$), and (iii) it also reduces crop quality produced by farmers remaining in such a relationship ($\partial z/\partial M < 0$).

4. A motivating example: wheat trading in Ethiopia

We collected panel data on product quality, the intensity of local competition, and relational contracting in local wheat markets in rural Ethiopia between December 2019 and March 2020 (see fig. B.1).We use these data to probe whether our theoretical predictions make sense. Importantly, it is well understood that the sample of markets is small and that endogeneity issues invalidate causal interpretations of our correlations. For example, being in a relationship with a trader is unlikely to be a random event. We therefore hasten to clarify that the data presented in this section serve as a motivational example only—not as a formal test of any specific theory.Nevertheless, we believe the patterns in these data are interesting (and encouraging for this sort of modeling). Wheat is an essential agricultural commodity in Ethiopia and is supplied by 5million smallholders (Central Statistical Agency, 2014). Between 1995 and 2013, the annual growth rate of wheat production equaled 7.5%. Production now equals some 3.9 million tons per year, and Ethiopia is the largest sub-Saharan Africa wheat producer (Minot et al., 2019). However, adoption of modern technologies is incomplete, and markets are spatially segregated. Formal contract enforcement is lacking or too expensive, and much of the trade at the local level is governed by informal arrangements. As a result, the wheat value chain is quite complex (Gebreselassie et al., 2017).

Wheat is mainly bought by local traders in production areas. They purchase wheat throughout the *woreda* (an administrative unit; described later) and sell it to retailers or millers. Markets are located in rural and urban areas and are open from once every 2 weeks to every day, depending on the market's importance. The number of markets is large, but bad road conditions and lack of access to motorization increase farmers' travel time—reducing opportunities for spatial arbitrage. Most smallholders sell their produce on the same market repeatedly, typically small quantities multiple times per year. In contrast, traders typically frequent multiple markets in a rotational fashion.[19] At the local level, some evidence suggests traders have market power (Osborne, 2005), perhaps because of the remoteness of markets combined with asymmetric (price) information, license costs, and formal restrictions regulating entry in the trader sector.[20]

A formal system of grading and standards exists for wheat, but quality assessment and certification are limited to large consignments. Smallholder farmers are excluded from this system given the small size of individual transactions and the large fixed costs to use this service (Abate et al., 2021; Anissa et al., 2021). Instead, traders assess wheat quality on the basis of observables and weight. Observational characteristics include the moisture rate, the rate of impurities, and the varietal mixture (Abate and Bernard, 2017). Increasing wheat quality is possible but costly for farmers in terms of time (effort) and money (Kadjo et al., 2016). It requires sorting, drying, and sometimes purchasing specific inputs (e.g., seed of specific varieties). Because many farmers are liquidity constrained, traders may help farmers access inputs, sometimes via provision of credit.

4.1. Data

We collected data on local wheat markets in Ethiopia's wheat-producing areas in two rounds during the 2019–20 marketing season: (i) late 2019 and (ii) early 2020. During the first wave, we visited 60 markets. Fieldwork during the second wave was cut short by COVID-19, so we visited only 58 of these markets. While we refer to these markets as "wheat spot markets," they are multipurpose markets where a range of goods and services is traded (Abay and Hirvonen, 2017). These markets are visited by spot-market farmers as well as farmers engaging in relational contracting. While relational farmers use the farm-gate channel to sell part of their wheat crop to their fixed partner, they sell smaller quantities of wheat throughout the season (perhaps to that same partner). Not all wheat matures simultaneously, as farmers use multiple plots. Farmers also sell out of their private stocks to manage liquidity constraints—for example, when they need cash to purchase food. Random sampling of market visitors therefore yields a sample that consists of both spot-market and relational farmers. We aimed to randomly select 30 farmers per market to obtain a representative sample.

Following Krishna and Sheveleva (2017b), we use the number of traders relative to the

[19] The movement of traders is conducive to the spreading of information about defaulting farmers.

[20] Unlike cooperatives, traders provide immediate payment, which is valued by liquidity-constrained farmers.

number of farmers on market j at time t as our proxy for the intensity of trader competition for market j at time t.[21] We also asked farmers whether they are in a more or less permanent relationship with any specific trader (our measure of relational contracting for farmer i). Such a relationship involves the promise to trade, possibly facilitated by exchanging inputs or providing credit.[22] We compute the share of farmers in a relationship (share of farmers in relation for market j at time t).

Wheat quality is measured using both objective and subjective measures. First, our objective measure is based on a sample of 1 kg of wheat bought from farmers on 60 markets (during wave 1) and 58 markets (wave 2). We assessed wheat quality on the basis of three criteria: (i) extraction rate, the quantity of flour that can be obtained from 1 kg of wheat; (ii) moisture rate, negatively correlated with nutrition value and associated with spoilage; and (iii) impurity rate, the share of matter in the sample other than wheat. The sample was graded as low, medium, or high quality for each attribute, with higher scores corresponding to higher quality. Unfortunately, the COVID-19 pandemic prevented timely quality assessment of wheat purchased on 13 markets during both waves. Wheat from 12 markets was graded with a 6-month delay, and for one market all samples were lost. Storage conditions during this delay were poor, so wheat quality of the 12-market subsample was compromised at the time of measurement. Therefore, our preferred sample consists of 47 markets for which we have measured quality in a timely fashion. The results of the (near) total sample of 59 markets are provided in the appendix.

Importantly, the impurity and moisture rate are observable characteristics—impurity is easily assessed by looking in the wheat bag, and experienced traders can assess moisture. In contrast, measuring the extraction rate requires a specific tool that traders do not own (Anissa et al., 2021; World Bank, 2018). Ethiopian wheat traders do not use equipment to measure quality but rely on their senses (as informal interviews with traders confirm).

Our second quality measurement is available only for the sample of 58 markets visited during the second survey wave. During this wave, we asked farmers to provide a (subjective) self-assessment of the quality of the wheat they supplied (either low, medium, or high).

In table A.1, we show that wheat prices positively correlate with impurity and subjective wheat quality. The spot market rewards observable quality and presumably only attributes that are observable to both the trader and farmer (a farmer unknowingly supplying high-

[21] We obtain qualitatively similar but statistically weaker results if we use the number of traders instead of the trader/farmer ratio as competition proxy.

[22] Unfortunately, we lack information about input or credit provision.

quality crop will likely be underpaid and receive a relatively low price). For extensive analysis of the returns to quality on local markets, refer to Do Nascimento Miguel (2022). Previous work on quality premiums (e.g., Abate and Bernard, 2017; Kadjo et al., 2016) also suggests that impurity is the characteristic most easily observable for both traders and farmers and most important for prices.

We also collected information on farmer demographics, plots, quantities supplied, and market characteristics. Finally, we introduce *woreda* fixed effects in our estimates and time fixed effects where appropriate. *Woredas* are administrative units encompassing multiple markets within the same agro-ecological zone. Summary statistics of our variables are provided in table A.2.

4.2. Competition and the intensive margin

We first probe our theoretical predictions concerning the intensive margin and ask whether variation in the quality of wheat supplied by farmer i on market j at time t (Q_{ijt}) is correlated with the level of competition on local market j at time t, with own relationship status, and the interaction between these two variables:

$$Q_{ijt} = \alpha + \beta \text{Competition}_{jt} + \gamma \text{Relation}_{ijt} + \delta \text{Competition}_{jt} \times \text{Relation}_{ijt} + \Theta X_{ijt} + \mu_j + \rho_t + \epsilon_{ij} \tag{17}$$

Coefficient β captures the effect of competition on wheat quality for spot market farmers who are not in a relationship, γ captures the effect of being in a relationship on wheat quality, and $(\beta + \delta)$ captures the effect of competition for farmers who are in a relationship. We test the theoretical prediction that $\delta < 0$. The Cournot competition model also predicts that input provision by traders increases quality, hence $\gamma > 0$. Dependent variables Q_{ij} are dummy variables equal to 1 if the farmer supplied high-quality wheat according to specific measures, and 0 otherwise. Vector X captures farmer and market covariates. The terms μ_j and ρ_t are *woreda* and time fixed effects, respectively. Results for the subsample of 47 markets where quality was measured without delay are reported in table 1. We cluster standard errors at the local market level in all models.[23]

[23] Results of the full sample, including the 12 markets where we measured quality with a 6-month delay, are reported in table A.3. While the signs of the relevant coefficients are unaffected, not surprisingly significance levels are compromised by the increased variance of our quality variable.

In columns 1–6 of table 1, we regress objective measures of wheat quality on our proxies of competition and "being in a relationship," and in columns 7 and 8 we use subjective wheat quality as the dependent variable. The quality measures in columns 1–4 are observable by traders and farmers (impurity is more straightforward to observe than moisture), but this is not the case for the flour extraction rate variable in columns 5 and 6.[24]

Observable and subjective quality measures are positively correlated with the intensity of local competition. However, this correlation is not statistically significant for the extraction rate (the unobservable quality attribute). This result is not consistent with our simple spot-price prediction that the quality of farmers' supply does not vary with competition. Instead, this outcome suggests an alternative process of price formation on the spot market, such as bilateral bargaining between trader and farmer over the price, where part of the quality premium is claimed by the trader—driving a wedge between marginal cost and marginal benefit of quality investments for the farmer.

It is interesting to observe in column 6 of table 1 that we obtain an opposite result for the (unobservable) extraction rate. Farmers have no reason to invest in enhancing quality along this dimension because it does not affect the price they can negotiate (table A.1).We speculate this variable correlates with another observable variable that affects price, such as grain color. The finding that the predicted correlations are found only for observable measures suggests that the results in table 1 might capture something more than just "associations" between variables (if biases from the correlational analysis are common across quality measures).

We find similar patterns for the subjective quality measure as for the observable quality measures. While farmers do not have access to certification services or quality-assessment tools, their knowledge relies on experience and observable attributes. Anissa et al. (2021) and Do Nascimento Miguel (2022) demonstrated that farmers' quality self-measurement is highly correlated with measured quality. Finally, we conduct a robustness check to control for any variation in quality and quantity across markets. Given that market competition is spatially correlated, we construct a market-access measure following Donaldson and Hornbeck (2016). Specifically, this control is the average measure of competition excluding the current market in consideration weighted by the inverse of the distance to other markets. We report the results in table A.4, and these support those previously found in table 1.

[24]The number of markets varies slightly across columns because there was no within-*woreda* variation in quality across farmers for a few markets. If the quality variable was collinear with the *woreda* fixed effect, the observation was dropped

Result 1. Correlations in our observational data are mostly consistent with model prediction 1: observable crop quality in relational contracting goes down if the intensity of competition on local spot markets increases. However, the quality of wheat supplied by spot-market farmers on "competitive markets" is higher than on markets where there is little competition between traders (which is not consistent with Cournot bargaining on spot markets).

4.3. Competition and the extensive margin

The theory predicts that more farmers will be included in relationships when the local spot market is less competitive (when traders have more market power). The reason is that the incentive compatibility constraint for the marginal farmer is relaxed when prices paid on local markets go down. In table 2, we report correlations between the share of farmers in a relationship and the competitiveness of the local market. In both columns, we regress the share of farmers in a relationship in market j at time t on our measure of competition in market j at time t, with and without controls:

$$\text{\% of farmers in relation}_{jt} = \alpha + \beta \text{Competition}_{jt} + \gamma X_{jt} + \mu_j + \rho_t + \epsilon_{jt} \tag{18}$$

There exists a negative correlation between the intensity of competition and the share of local farmers in a relationship. Hence, and consistent with our theory, relational contracting is more inclusive when traders have more market power on local markets, and temptation to renege by farmers goes down.

The theoretical model was based on the assumption of farmers who are identical in all but one dimension: access to the nearest wheat market. This defines a "critical distance" threshold for which relational contracting can be supported. To probe this issue, we use two proxies for market access: a survey based measure of travel time of farmer i to the nearest local market (in minutes) and distance between the farm household and the nearest wheat market (in kilometers),

$$\text{Relation}_{ijt} = \alpha + \beta \text{Competition}_{jt} + \gamma \text{Dist.}_{ijt} + \delta \text{Competition}_{jt} \times \text{Dist.}_{ijt} + \Theta X_{jt} + \mu_j + \rho_t + \epsilon_{ij} \tag{19}$$

We provide correlations for both access proxies in table 3, and they provide weak support for the theory. First, consider the prediction regarding the "level effect" of market access: farmers with less access to markets are more likely to be in a relationship than farmers with better access: $\gamma > 0$. While we obtain the expected result for our distancemeasure (col. 2), the theory is not supported when we use travel time as a proxy for market access, for which we find no significant correlation with relational contracting ($\gamma = 0$). This may be because the theory simplified matching costs for traders reaching out to farm households (which focused on the social distance between farmer i and trader k but did not feature the geographic location of farmer i). While farmers living "far away" from markets are attractive partners for traders because of their low propensity to renege on agreements, this benefit may be eroded if trader transaction costs are high. The relation between distance and the probability of engaging in relational contracting will be more complex if traders' transaction costs increase in distance. This could be an important topic for future research.

Second, consider the interaction term. We predict that competition especially erodes relational contracting if farmers live far away from markets (because these are more likely to be selected for relationships). For farmers who need more time to travel to the market (col. 1 of table 3), more intense competition is indeed associated with a lower probability of being in a relationship with a trader ($\delta < 0$).We also find a negative correlation when using the travel distance measure (col. 2 of table 3). This suggests that relationships for far away farmers become less inclusive as competition intensifies—as predicted.

Result 2. Our results are mostly consistent with prediction 2 of our model. Fewer farmers are included in relational contracting if the competition on local spot markets increases. Moreover, farmers farther away from local markets are crowded out of relational contracting when markets become more competitive. However, the role of market access in the selection process of farmers for relational contracting is complex.

5. Discussion and conclusions

This paper connects two key issues in agricultural underdevelopment: the perceived lack of competition on remote commodity markets and the low quality of smallholder supply. Our main result is an application of the well-known theory of the second best (Lipsey and Lancaster, 1956). In a context with multiple market distortions (imperfect contracting and imperfect competition), addressing one distortion may reduce overall efficiency rather than increase it. We argue that policies aiming to increase competition between traders may impede relational contracting and decrease the quality of smallholder supply on local markets.

The reason is as follows. If formal contracting is expensive, relational contracting may emerge as a substitute. Relational contracting enables matched partners to negotiate the price of the crop as well as its quality and associated levels of input supply. We assume that traders can provide quality-enhancing inputs that are inaccessible for farmers, and we develop a model where traders and farmers can either trade on the spot market or engage in a relationship. Hence, the opportunity cost of relational contracting is endogenously determined by (potential) earnings on the spot market. These latter earnings are a function of the intensity of competition: farmers fare better on the spot market as it becomes more competitive.

Relational contracts in which more inputs are transferred can be negotiated when the fall-back position on the spot market is "worse" for farmers—when traders grab a greater share of the crop's value. Our model shows that when competition between traders increases, they provide smaller quantities of quality enhancing inputs to farmers, which lowers the quality of the crop farmers supply in an informal relationship. We identify the subset of farmers who can be included in relational contracting and explore the nature of the contract that is negotiated.We predict that more competition between traders lowers crop quality by crowding out relational contracting. We present anecdotal evidence consistent with predictions about shifting intensive and extensive margins by using data from a sample of Ethiopian wheat markets.However, we hasten to add that causal interpretations are necessarily speculative because we do not have exogenous variation in key variables.

Policy interventions that promote the competitiveness of local markets (more permits for traders, investments in rural infrastructure that reduce transport cost) may thus "backfire" in the sense that they undermine the ability to engage in relational contracts and commit to cooperative behavior. As a result, technology transfer may be stalled, and the value of farmers' agricultural production matched with a trader will decrease. The aggregate effect of such interventions on quality is therefore difficult to predict.

An important lesson is that interventions aimed at increasing competition on markets will have distributional consequences in addition to the (complex) effects on crop quality and efficiency. For instance, if relational contracts involve input provision by traders, farmers receive an efficiency premium to prevent side selling—a form of profit sharing between trader and farmer. Policies that make local markets more or less competitive will directly affect the income of spot-market traders but will also have an effect on the set of farmers qualifying for an efficiency premium and the magnitude of that premium. Most reform measures will therefore create winners and losers among the population of farmers.

Table 1. Competition, relational contracting and quality of wheat production

	Objective quality						Subjective quality	
	Moisture		Impurity		Extraction rate			
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Competition	1.48**	1.99***	1.21**	1.52***	-0.58	-1.2*	1.33***	2.39***
	(0.7)	(0.76)	(0.52)	(0.47)	(0.58)	(0.73)	(0.45)	(0.75)
Relationship	-0.09	0.17	0.01	0.12	0.11	-0.24	0.17	0.71**
	(0.16)	(0.22)	(0.12)	(0.16)	(0.19)	(0.25)	(0.24)	(0.3)
Competition × relationship		-1.75*		-0.8*		2.39*		-3.06***
		(0.91)		(0.49)		(1.39)		(1.61)
Constant	-0.52	-0.48	2.91	3.03	-10.09***	-10.3***	-6.56***	-6.78***
	(5.85)	(5.71)	(2.36)	(2.36)	(3.64)	(3.73)	(1.74)	(1.56)
Controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Spatial FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Number farmers	2140	2140	1852	1852	2047	2047	1693	1693
Number markets	47	47	41	41	45	45	58	58

Source: Authors' computation based on 2019/2020 wheat markets survey.
Notes. Logistic regression models, dependent variable is wheat quality supplied by smallholders and equals to one if it is a high-quality wheat. Included controls: type of wheat product by farmer *i*, yearly wheat production by farmer *i*, quantity supplied by farmer *i*, plot size of farmer *i*, farmer *i* distance to market *j* in kilometers, age of farmer *i*, gender of farmer *i*, distance market *j* to Addis Ababa (equals to one if the market is among the farthest from Addis), rank of market *j* (equals to one if it is the main district market), number of cooperatives and flour factories active on market *j*, market *j* weather on surveyed day, presence of a price information board on market *j*, altitude of market *j*, survey month (or week in columns (7) and (8)) and enumerators. *Woreda* fixed effects are included. Standard errors in parentheses are clustered at the market level. *Woreda* and surveyed month fixed effects are included. Standard errors in parentheses are clustered at the market level. FE = fixed effects. *** p<0.01, ** p<0.05, * p<0.1.

Table 2. Competition and the extensive margin of relational contracting

	Share of Farmers in Relation	
	(1)	(2)
Competition	-.55***	-.54***
	(.16)	(.16)
Constant	1.88***	.41***
	(.42)	(.12)
Controls	Yes	No
Spatial and Time FE	Yes	Yes
Number of farmers	3483	3483
Number of markets	60	60

Source: Authors' computation based on 2019/2020 wheat markets survey.
Notes. Ordinary least square regression models, dependent variable is the share of farmers in a relationship. Included controls: type of wheat product by farmer i, yearly wheat production by farmer i, quantity supplied by farmer i, plot size of farmer i, farmer i distance to market j in kilometers, age of farmer i, gender of farmer i, distance of market j to Addis Ababa (equal to 1 if the market is among the farthest from Addis Ababa), rank of market j (equal to 1 if it is the main district market), number of cooperatives and flour factories active on market j, market j weather on surveyed day, presence of a price information board on market j, and altitude of market j. *Woreda* and surveyed month fixed effects are included. Standard errors in parentheses are clustered at the market level. FE = fixed effects. *** p<0.01, ** p<0.05, * p<0.1.

Table 3. Competition, distance and the extensive margin of relational contracting

	Relationship	
	(1)	(2)
Competition	1.51	0.23
	(1.75)	(1.22)
Travel time to market	0.08	
	(0.11)	
Distance to market		0.20*
		(0.12)
Competition × Travel time	-0.88**	
	(0.40)	
Competition × Distance		-1.13**
		(0.52)
Constant	5.27**	5.55**
	(2.54)	(2.60)
Controls	Yes	Yes
Spatial and time FE	Yes	Yes
Number farmers	3471	3471
Number markets	60	60

Source: Authors' computation based on 2019/2020 wheat markets survey.
Notes. Logistic regression models, dependent variable is a dummy equals to one if the farmer is in relational contracting. Included controls: type of wheat product by farmer i, yearly wheat production by farmer i, quantity supplied by farmer i, plot size of farmer i, famer i distance to market j in kilometers (only in column 1), farmer i travel time to market j in minutes (only in column 2), age of farmer i, gender of farmer i, distance market j to Addis Ababa (equals to one if the market is among the farthest from Addis), rank of market j (equals to one if it is the main district market), number of cooperatives and flour factories active on market j, market j weather on surveyed day and altitude of market j. *Woreda* and surveyed month fixed effects are included. Standard errors in parentheses are clustered at the market level. FE = fixed effects. *** p<0.01, ** p<0.05, * p<0.1.

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Appendix

A. Tables

Table A.1. Wheat prices and wheat quality

	Objective Quality			Subjective Quality
	Moisture	Impurity	Extraction Rate	
	(1)	(2)	(3)	(4)
Wheat Quality	-0.01	0.02***	0.01	0.02***
	(0.01)	(0.01)	(0.01)	(0.01)
Constant	2.67***	2.65***	2.67***	2.89***
	(0.26)	(0.26)	(0.26)	(0.17)
Controls	Yes	Yes	Yes	Yes
Spatial and Time FE	Yes	Yes	Yes	Yes
Number farmers	2133	2133	2133	1676
Number markets	47	47	47	58

Source: Authors' computation based on 2019/2020 wheat markets survey.
Notes. OLS regression models, dependent variable is wheat price in Birr per kg obtained by farmer i (logarithmic form), wheat quality supplied by smallholders and equal to one if it is a high-quality wheat. Included controls: type of wheat product by farmer i, yearly wheat production by farmer i, quantity supplied by farmer i, plot size of farmer i, farmer i distance famer to market j, age of farmer i, gender of farmer i, distance market j to Addis Ababa (equals to one if the market is among the farthest from Addis), rank of market j (equals to one if it is the main district market), number of cooperatives and flour factories active on market j, market j weather on surveyed day, presence of a price information board on market j, altitude of market j. *Woreda* and week fixed effects are included. Standard errors in parentheses are clustered at the market level. FE = fixed effects. *** p<0.01, ** p<0.05, * p<0.1.

Table A.2. Summary statistics

Variables	N	Min	Max	Mean	St.Dev
Impurity	2950	0	1	0.678	0.475
Test weight	2946	0	1	0.287	0.453
Moisture	2949	0	1	0.672	0.469
Subjective quality	1694	0	1	0.319	0.466
Competition	3484	0.004	0.932	0.133	0.157
Weighted Competition	3364	0.027	0.282	0.135	0.061
Relationship	3484	0	1	0.546	0.498
Wheat	3484	0	1	0.94	0.237
Production	3484	7	55000	2723.263	3431.445
Quantity sell	3484	2	2500	83.084	129.959
Plot size	3484	0.025	12	0.984	0.907
Travel time	3483	0.25	240	58.004	46.144
Distance to Market	3472	0	60	6.405	5.331
Age	3484	12	100	36.373	13.586
Gender	3484	0	1	0.541	0.498
Distance to Addis Ababa	3484	0	1	0.4691	0.499
Central market	3484	0	1	0.505	0.5
Cooperatives	3484	0	4	0.964	1.082
Flour factories	3484	0	8	1.612	2.142
Weather	3484	0	1	0.863	0.344
Information board	3484	0	1	0.017	0.130
Altitude	3484	1819	3072	2326.839	250.982

Source: Authors' computation based on 2019/2020 wheat markets survey.
Notes. Weighted competition measures the weighted average measure of competition excluding the market j. The weights are the inverse of the distance in km to these other markets. Wheat is equal to one for bread wheat and zero for durum wheat, production and quantity sell are in kg, plot size is in Ha, travel time to market is in minute, distance to market in km, gender is equal to one for male and zero for female, distance to Addis Ababa is equal to one if the market is among the 50 percent farthest from Addis Ababa, cooperatives is the number of cooperatives that actively buy wheat in the market, number of flour factories is at the *Woreda* level, weather is equal to one if the surveyed day was not rainy, information board is equal to one if there is a price information board in the market, altitude is in meters.

Table A.3. Competition, relational contracting and quality of wheat production (full sample of markets)

	Objective quality					
	Moisture		Impurity		Extraction rate	
	(1)	(2)	(3)	(4)	(5)	(6)
Competition	1.09*	1.41*	0.27	0.49	-0.30	-0.66
	(0.66)	(0.73)	(0.57)	(0.52)	(0.77)	(0.84)
Relationship	-0.06	0.08	-0.10	-0.04	0.16	-0.02
	(0.15)	(0.22)	(0.11)	(0.15)	(0.16)	(0.22)
Competition × relationship		-1.06		-0.53		1.30
		(1.0)		(0.61)		(1.36)
Constant	-3.08	-3.06	-4.43	-4.41	-7.01	-7.04
	(4.05)	(3.97)	(2.96)	(2.96)	(4.29)	(4.39)
Controls	Yes	Yes	Yes	Yes	Yes	Yes
Spatial FE	Yes	Yes	Yes	Yes	Yes	Yes
Number farmers	2922	2922	2696	2696	2676	2676
Number markets	59	59	53	55	52	52

Source: Authors' computation based on 2019/2020 wheat markets survey.
Notes. Logistic regression models, dependent variable is wheat quality supplied by smallholders and equals to one if it is a high-quality wheat. Included controls: type of wheat product by farmer *i*, yearly wheat production by farmer *i*, quantity supplied by farmer *i*, plot size of farmer *i*, farmer *i* distance to market *j* in kilometers, age of farmer *i*, gender of farmer *i*, distance market *j* to Addis Ababa (equals to one if the market is among the farthest from Addis), rank of market *j* (equals to one if it is the main district market), number of cooperatives and flour factories active on market *j*, market *j* weather on surveyed day, presence of a price information board on market *j*, altitude of market *j*, survey month (or week in columns (7) and (8)) and enumerators. *Woreda* fixed effects are included. Standard errors in parentheses are clustered at the market level. *Woreda* fixed effects are included. Standard errors in parentheses are clustered at the market level. FE = fixed effects. *** p<0.01, ** p<0.05, * p<0.1.

Table A.4. Competition, relational contracting and quality of wheat production (corrected for spatial correlation)

	Objective Quality			Subjective Quality
	Moisture	Impurity	Extraction Rate	
	(1)	(2)	(3)	(4)
Competition	0.81	1.16**	-1.31*	2.38***
	(0.88)	(0.58)	(0.74)	(0.76)
Relationship	-0.10	0.31	0.02	0.73*
	0.30	(0.25)	(0.48)	(0.39)
Competition × relationship	-1.64**	-0.93*	2.14	-3.11*
	(0.83)	(0.52)	(1.33)	(1.63)
Weighted Competition	-10.67**	-2.12	-1.83	0.08
	4.27	(2.80)	(2.77)	(4.00)
Weighted Competition × relationship	2.51	-0.83	-1.40	-0.05
	(2.33)	(1.57)	(2.67)	(3.34)
Constant	2.16	3.37	-10.39***	-7.80***
	(5.50)	(2.51)	(3.96)	(1.89)
Controls	Yes	Yes	Yes	Yes
Spatial FE	Yes	Yes	Yes	Yes
Number farmers	2107	1821	2016	1633
Number markets	46	40	44	56

Source: Authors' computation based on 2019/2020 wheat markets survey.
Notes. logistic regression models, dependent variable is wheat quality supplied by smallholders and equals to one if it is a high-quality wheat. Weighted competition measures the weighted average measure of competition excluding market j. The weights are the inverse of the distance in km to these other markets. Included controls: type of wheat product by farmer i, yearly wheat production by farmer i, quantity supplied by farmer i, plot size of farmer i, farmer i distance to market j in kilometers, age of farmer i, gender of farmer i, distance market j to Addis Ababa (equals to one if the market is among the farthest from Addis), rank of market j (equals to one if it is the main district market), number of cooperatives and flour factories active on market j, market j weather on surveyed day, presence of a price information board on market j, altitude of market j, survey month (or week in column (4)) and enumerators. *Woreda* fixed effects are included. Standard errors in parentheses are clustered at the market level. FE = fixed effects.
*** p<0.01, ** p<0.05, * p<0.1.

B. Figures

Figure B.1. Markets sampled in the survey.