

# Imperfect competition in agricultural markets: evidence from Ethiopia

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Received 1 February 2001; accepted 1 February 2004

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## Abstract

Drawing upon unique transaction-level data from rural Ethiopia, this paper tests for general forms of imperfect competition among rural wholesale traders. These are key to the grain distribution system as they purchase from farmers and perform interregional trade. Tests show that traders in a typical source market engage in imperfectly competitive behavior in purchasing from farmers, driving down the price paid to farmers approximately 3%. In contrast, there is no conclusive evidence of imperfect competition among traders in the larger, more centrally located market studied. Thus, efficiency losses due to market structure are likely to be greatest in markets which also have poor road links and lesser volumes of marketed grain.

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*JEL classification:* D43; L13; O12; Q13

*Keywords:* Imperfect competition; Seasonality; Agricultural marketing system; Africa

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## 1. Introduction

This paper examines the performance of agricultural output markets in Ethiopia, a country noted for its low agricultural productivity and high food insecurity. There is growing recognition among economists and policymakers of the importance of market performance in providing appropriate production and consumption incentives in such settings.<sup>1</sup> Yet, little

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<sup>1</sup> The classic works on the relationship between markets and famine or food security are Ravallion (1987) and Sen (1981).

is known about even the most critical markets. Some Ethiopian observers allege, for instance, that grain traders “cheat” farmers by paying too low a price for their grain. Traders and brokers themselves admit to discussing (and in the case of brokers, setting) prices (*source*: Interviews by author). If present, imperfect competition in these markets would have important efficiency and distributional effects. It could, moreover, raise the price paid by net grain consumers, among whom number the most vulnerable sectors of the population.<sup>2</sup>

Concerns about the distributional consequences of unchecked market forces, in addition to other economic and political agendas, have prompted many governments to intervene directly in output markets using such means as marketing boards, price controls, and strategic stock-holding. Ethiopia has been a particularly unfortunate example of this, having endured a period of severe state intervention in the grain trade. In 1979/1980, the former (*Derg*) government adopted a set of measures, collectively called the ‘quota system’, which heavily taxed both farmers and wholesale traders, restricted trading licenses, and imposed severe penalties (including imprisonment and death) on violators. Abandoned in 1990, the quota system has been partly blamed for Ethiopia’s persistent problems of low agricultural productivity, food insecurity, and famine (see, e.g., Franzel et al., 1989, Lirenso, 1987).<sup>3</sup> Throughout this period, however, a private grain market survived and some traders actually thrived. The abolition of the quota system in 1990–1991 led, as might be expected, to a general reduction in the risks and costs of trading. Entry resulted, and the efficiency of these markets has improved dramatically. Dercon (1993), for example, has shown that market integration within the country improved substantially following 1990. In addition, traders surveyed in 1994 unanimously reported that trading margins were much higher (and volumes lower) under the quota system, suggesting a marked improvement in efficiency (*source*: Traders’ Survey by author).

This paper tests for deviations from perfect competition in interregional trade under the relatively free market conditions that prevail in post-1990 Ethiopia. There is a substantial body of research on imperfect competition in developed markets in goods ranging from fish (see, e.g., Graddy, 1995) to asset trading (e.g., Wang, 1999), automobiles and airline seats. Yet, despite considerable policy attention, there is little empirical research on conditions in developing country markets, where the effects would be arguably more severe (here, exceptions include, e.g., Aleem, 1990; Ellis, 1993; Usher, 1968).<sup>4</sup>

The primary reason for the general paucity of empirical studies, it seems, is the lack of suitable data. Thus, unique data were collected for the purpose of this paper on

<sup>2</sup> Earlier studies of Ethiopian grain markets have found suggestive evidence of imperfect competition. For example, Pickett (1991) estimates the internal rate of return on trading to be 48% using data collected in 1957. This may indicate super-normal profits.

<sup>3</sup> The country’s long period of civil war is also considered a part of the explanation, although the true causes are undoubtedly many.

<sup>4</sup> Other studies of agricultural markets include Fafchamps and Minten (2002), which examines the role of social network capital for traders in Madagascar, and Gabre-Medhin (1999a, 1999b), who examines the role of brokers in reducing transactions costs in Ethiopia.

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