Self-enforcing contracts in agriculture

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Summary: This article examines a self-enforcing contract between a risk-neutral principal and a risk-averse agent who is able to hold up values ex post. It shows that risk aversion and variance can only partly explain the contract's incentive intensity. Ex post bargaining power and outside options will also determine contract choice. If the agent's ex post bargaining position is weak, the principal cannot commit to high-powered incentives, whereas if the agent's ex post bargaining position is good, the agent cannot commit to low-powered incentives. The model may thus explain some puzzles in agricultural contracts, in particular why risk-averse agents sometimes accept to be governed by high-powered incentive contracts that are quite similar to fixed rental contracts, and why risk-neutral agents are sometimes offered share contracts with lower-powered incentives.

Keywords: relational contracts, hold-up, moral hazard, risk aversion

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