Under what conditions does exposure to trade lead to coercion and poverty for indigenous communities, and when may it lead to market access, poverty reduction and ethnic assimilation? We explore the role played by contractual incentives generated by inter-ethnic complementarity and costly verifiability in securing long term, sustained gains and engendering ethnic assimilation among indigenous communities involved in the cultivation of one of the world’s most valuable traded commodities: cochineal - the "Spanish Red".

We exploit the discontinuous fragility of cochineal with respect to micro-climatic differences during the growing season to identify the effect of a legacy of cochineal production. We find that a legacy of cochineal production lowered the headcount poverty ratio in Mexican municipalities by 0.1—comparable to the entire ten year effect of Progresa/Oportunidades— and raised female literacy by 0.6 percentage points. However, municipalities that once produced cochineal are more unequal, have fewer indigenous households and are less likely to formalize indigenous local government institutions. Further, and unlike non-cochineal producing areas, the greatest female literacy and poverty gains occurred in areas where indigenous agents were best able to renege on contracts. Drawing on original historical sources, including a secret handbook for Spaniards bidding for local office, we interpret these results as reflecting inter-ethnic complementarity in trade, and, ironically, weak contract enforceability by intermediaries that encouraged direct market access for the indigenous, particularly women.