Zambian Agricultural Commodity Exchange: Institutional Changes and Persistent Challenges

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Objectives of Presentation

1) Why commodity exchanges would be beneficial to African food markets
2) Institutional challenges impeding ZAMACE’s development
3) Recent restructuring at the exchange
4) Persistent policy challenges
5) Conclusion
Institutional solutions to Africa’s food market challenges?

• In developed agricultural markets, commodity exchanges serve to:
  • Manage risk
  • Reduce costs
  • Provide transparent price discovery
  • Increase market activity and decrease price volatility
Yet they remain under-utilized

- Total value of trade on ZAMACE $US 72 million (2008-2010)
- Estimated annual value of wheat trade in Zambia $60 million
Why has it failed to develop?

Institutional Challenges
1) Limited capacity to enforce contracts;
2) Insufficient incentives to develop competitive brokerage services;
3) Costs of operating the exchange exceed the benefits of using it for many potential participants;
4) Exchanges perceived as vehicles for manipulating markets, rather than as forums to achieve price discovery
Constraint #1: Contract enforcement challenges

Market environment characterized by high risk of contract default

Perception that the exchange is unable to protect against contract shirking and opportunist behavior

Perception that exchange can attract risky trading partners

Limited participation in commodity exchanges

Risk mitigation in traditional trading involves investments in long-term relationship with a known buyer/seller, which are not well-suited to an anonymous and transparent exchange

Raises the potential transaction costs of using the exchange relative to traditional trading
Opting out by potential participants and limited outreach by brokers

Thinly traded exchange traditional trading margins exceed brokerage commissions

Constraint #2: Limited incentives for brokerage services

Potential conflict of interest

Limited incentives to invest in brokerage services

Exchange brokers wear two hats: broker/traders

Exchange enrolls existing market actors
Constraint #3: Costs exceed benefits

- Thinly traded markets increases unit cost of operating an exchange
- Potential participants opt out of the exchange
- Costs of participation exceed benefits derived from the exchange
- Increased membership fees
- Increased reliance on donor funds to cover operating costs

 Raises question of sustainability
Constraint #4: perception that exchange is used to manipulate markets not for fostering price discovery

Potential for price collusion

Existing members opt out of exchange

Small spot market/thinly traded exchange

Deprives exchange of possible trade volume

Potential participants remain on the sideline

Exacerbated by high number of “registered” trades: 68% of all trades between 2008-2010
Restructuring at the Exchange

- July 2011: Members given a choice to relinquish their seats or to continue as members
  - Four members remained (Cargill, CHC, Quality and Afgri)
  - Their future contributions will be converted to an equity share once an equity partner is found
- August 2011: Trade suspended on the exchange as restructuring began
- ZAMACE is negotiating ownership arrangement with LuSE
  - Seeking to address perceived conflict of interest in ownership structure
  - What the investment will look like is not yet finalized: majority shareholding, a share swap or even a full absorption of ZAMACE into LuSE.
Restructuring at the Exchange

• Streamlined it arbitration procedures: Set scale on duration, costs, and is developing a group of ZAMACE recognized arbitrators.

• Nominated as the warehousing authority under the agricultural credit act: Pave the way for WHR?

• ZAMACE CEO is in high level discussions with GRZ, WFP, and ZNFU

HOWEVER........
Policy Unpredictability Remains a Binding Constraint

Unpredictability:

Imposition of import/export restrictions, changes in tariff rates, variations in marketing board procurement, and release of government stocks at discretionary prices
- Disincentive to speculation
- Draws maize away from the exchange
- Disincentive to store grain
- Disincentive to enrolling financial institutions
Lusaka Maize Retail Prices

- Lusaka retail c.i.f. from South Africa
- Nominal US$ per metric ton
Conclusion

- ZAMACE is undergoing significant beneficial restructuring
- However, we must temper our expectations:

By their very nature commodity exchanges are designed to enhance the efficiency of already functional food markets. They cannot create functional markets in dysfunctional policy environments.

For those interest our report is available at: http://www.aec.msu.edu/fs2/zambia/wp53_revised.pdf
THANK YOU