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AGRICULTURAL COMMODITY EXCHANGES AND THE DEVELOPMENT OF GRAIN MARKETS AND TRADE IN AFRICA

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Objectives

- To assess the role commodity exchanges (CEs) can play in addressing grain market challenges
- Identify the necessary pre-conditions for the establishment of a successful exchange
- Summarize what CEs can and cannot do: Set expectations

Can commodity exchanges solve the major constraints facing African food markets?

1. High production and marketing costs
2. Constrained access to credit
3. Limited availability of new farm technology
4. Price volatility
5. Farmers' market access conditions

High production and marketing costs

- Can CEs reduce transactions costs?
  - Centralization of buyers and sellers
  - Won’t directly effect major costs associated with:
    - Transport
    - Labor/handling
    - Taxes

Access to credit

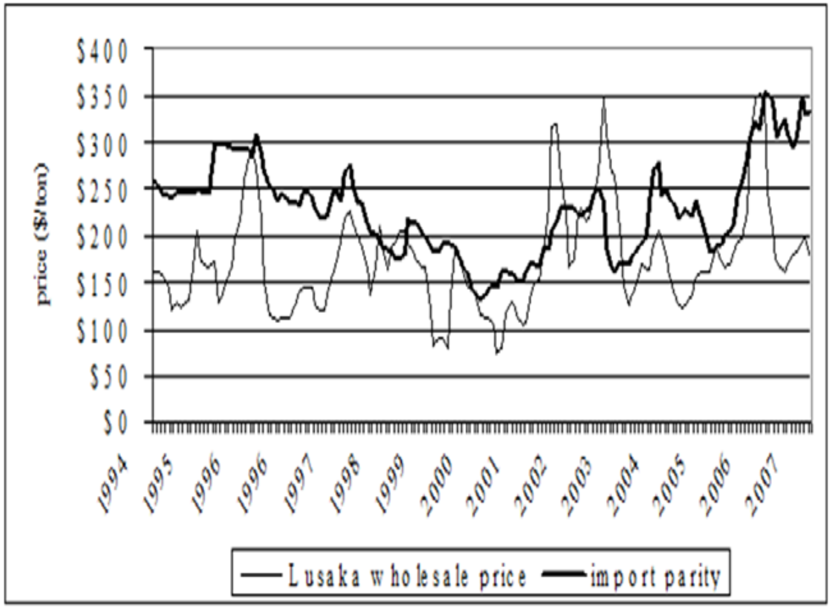
- Improve commercial credit for ag:
  - Generation of reference price
  - Lowers risk of agricultural lending
- Warehouse receipt system (WRS)
  - Collateral for ag lending
- Do exchanges improve credit access for smallholders?:
  - Direct: through WHRs
    - Likely a minority of farmers
  - Indirect: Increased credit supply in market
    - Seasonal credit from traders to farmers

Access to new farm technologies

- Can accelerate virtuous cycle of investment, but cannot create one:
  - Improved credit
  - Lower margins
    - Improved incentives and tool to intensify production

Price volatility

- Require prices to move based on supply and demand
- Do provide risk management tools and improved financing
  - Mitigate the consequences of price movements



Market access conditions

- Attracting new actors and leveling the playing field:
  - Price discovery
    - Limits asymmetric price information enjoyed by dominant actors
    - Competition stimulates assembly markets

Pre-conditions for a functional exchange

1. Pre-existing vibrant spot market
2. Potential to achieve sufficient volumes to cover fixed costs
3. Ancillary markets to allow low cost CE implementation
4. Institutional governance and incentives to motivate rapid learning
5. Commitment by governments to desist from unpredictable market intervention

Spot markets

- Markets with high numbers of buyers and sellers more conducive for CE development. However…
  - Traders: many markets characterized by dominant actors with entrenched interest in opaque markets
  - Demand side: dominant role of state agencies and relief organizations
- Strategies:
  - Contracts for a range of commodities
  - Small minimum contact size to bring in smallholders and small traders
  - Regional market participation

Volumes and fixed costs

- High fixed costs of opening and operating an exchange:
  - Legal and professional advice
  - Trading floor build-out
  - Arbitration services
  - Warehousing and certification systems
  - Range of $5 to 15 million (though some cheaper)
- Strategies:
  - Out-source collateral management and settlement services
    - Requires functional inter-bank transfer system and licensed collateral managers

Existing ancillary markets

- CEs develop more easily in markets with already established market structures:
  - Trade according to grades and standards
  - Specified delivery points and sufficient storage
  - Warehouse certification and collateral management services
  - Established dispute resolution systems
- Strategies: Don't focus solely on securing trading activity. Ensure that rules and procedures are clear and enforceable

Governance and incentives

- Commodity markets are competitive and dynamic:
- CEs must:
  - Possess flexibly and authority to take decisive action
  - Invest in new services
  - Borrow money if required to realize comparative advantage
- Strategies: Well conceived charters and regulations, experienced and competent management

Policy environment

- Likely crop candidates to trade on exchanges also politically sensitive
  - Pressure to intervene in markets through trade restrictions, marketing boards, price bands…
  - Elevates risk and deprives exchange of volume:
    - Thinly traded markets ➡ exit of participants ➡ collapse of exchange
- Strategies:
  - Commitment by governments to rules-based interventions
  - Focus on unregulated crops.
    - But raises questions about attracting sufficient volume

Summary

- CEs have potential to address challenges facing agricultural market
  - Primarily through indirect mechanisms:
    - Transparency/price discovery
    - competitiveness
    - risk management
  - CEs are not panaceas for constraints in African cereal markets
    - They are tools to enhance performance

Summary

- CEs cannot impose order on a market:
  - Preconditions must be met for CEs to thrive
  - Preconditions are:
    - Internal to the exchange
      - Rules, regulations, fund management
    - External to exchange
      - Competitive market, ancillary markets and services
      - Supportive policy environment

Thank you