

Commodity Exchanges – Practicalities and Pitfalls

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What is an agricultural Commodity Exchange?

- **Open and organized marketplace where ownership titles to (standardized) quantities or volumes of specific commodities (at a specified price and to be delivered on a specified date) are traded by its members for their clients.**

What is an agricultural commodity Exchange?

“An exchange equals change.”

- A commodity exchange allows people to do things that they could not do before, or to do what they could do, more efficiently.
- The greater the inefficiencies, the greater the benefits an exchange will bring; but also, the greater will be the barriers that an exchange will face.

What is an Agricultural Commodity Exchange

- By providing new tools, new efficiencies, an exchange acts as a catalyst for change, for converting an “old style” economy into a modern one. It is not merely a different platform for doing what would be done anyway.
- An exchange brings buyers and sellers together through their agents.
- An exchange is an agent of change – and this is what Africa needs.

What can an exchange do/achieve?

- Price Discovery” : the process by which a single market-clearing price is determined for a good at a given point in time.
- Product standardization: trading on an exchange requires that products are graded.
- Contract standardization: contracts are standardized on quality, quantity, time of delivery, and location-the only variable is price.
- Contract enforcement: mechanisms to arbitrate disputes.

Commodity Exchanges

- Reality check: -
- Not a panacea for all;
- Does **NOT** determine prices, which is a function of the market;
- Does not “guarantee contracts” or performance in spot/forward markets, but does offer arbitration;
 - Cannot advise market participants what to do.

How WRS and Commodity Exchanges Go Hand in Hand

- **Grades and standards:** are essential elements of warehouse operations as well as of exchange standardized contracts.
- **Price transparency:** If receipts indicate a specific grade, this generates price information that can also be used on the exchange .
- **Transfer of risk:** by selling receipts on the exchange, receipt holders engage in transactions and reduce risk for farmers.
- **Integrity and order:** the legal enforcement of quality and the receipt are vital for both the warehouse receipts system and the functioning of the exchange.

Requirements for Structured Trade Systems to Work

- Strong farmers organisations;
- Pro – active private sector;
- Governments to provide enabling environment not necessarily through regulatory powers (**in my view it is not coincidence that the most effective, efficient and relevant WRS and commodity exchanges function in countries where there is no government regulation – South Africa and Malawi**);
- Removal of political involvement in staple foods commodities especially maize (corn);
- Increased transparency in agricultural markets.

Requirements for Structured Trade Systems to Work

- Increased use of safe and secure storage facilities;
- Introduction and use of warehouse receipt systems which have integrity and provide security to depositors and the market;
- Improved transport and road infrastructure;
- Participating banks.

Change is long-overdue !

In agriculture

The world we have created is a product of our thinking; it cannot be changed without changing our thinking.

Albert Einstein

Commodity Exchanges in Africa

- ACE – Malawi
- ECX – Ethiopia
- KACE – Kenya
- MACE – Malawi
- UCE – Uganda
- ZAMACE – Zambia
- JSE (SAFEX) – South Africa (Futures Exchange)

Current Initiatives

- Kenya
- Rwanda
- Tanzania

10 Lessons

#1. In setting up a commodity exchange you must have-
A CLEAR OBJECTIVE

- You need to know what you want to set up and why.
- This is necessary for potential participants and for the general view (inside & outside).
- A business plan (prospectus) is a good way to start
- For a futures exchange the need to provide a price risk management facility.

10 Lessons

#2. A commodity exchange needs - ENABLING POLICY ENVIRONMENTS and GOOD INFRASTRUCTURE

- The building blocks are important
- Enabling & consistent legislation must be in place:
 - in agricultural policy;
 - in financial policy;
 - in trade policy;
 - in legal policy.
- Infrastructure (storage and transport) is important.

10 Lessons

#3. *A commodity exchange needs -* **MARKET SUPPORT (BUY IN)**

- The best organization, people, systems, contracts might help, but without market support it will be difficult to sustain an exchange.
- A mutual structure with monetary commitment helped us.
- The commitment from the financial sector (banks) was very important.
- Market support is a function of value-add.

10 Lessons

- #4. A commodity exchange needs -
an **APPLICABLE AND GOOD TRADING SYSTEM**
and an **EFFICIENT AND SOUND CLEARING SYSTEM**
- The trading system must be requirement driven, robust, flexible and allow for growth in all aspects.
 - The clearing system must be reliable and efficient and ensure confidence in the trading arena. (Futures exchanges).

10 Lessons

#5. A commodity exchange needs -
CLEAR RULES and **CONSISTENT SURVEILLANCE** to
maintain **INTEGRITY**.

- Primary role of government is regulating the exchange. (Where there is capacity to do so).
- An exchange requires clear and balanced rules that are consistently applied.
- An exchange requires ongoing surveillance. Integrity is paramount.
- Act decisively.

10 Lessons

#6. A commodity exchange needs -
the **CORRECT CONTRACTS (PRODUCTS)**

- The product traded must reflect reality.
- Should be developed in consultation and conjunction with the market.
- Balance between market initiatives and exchange initiatives.

10 Lessons

#7. A commodity exchange needs - CONSTANT EDUCATION

- Education should be a big part of marketing.
- Education should be aimed at: market participants. potential market participants, media, government officials, educational institutions.
- Education should be ongoing.
- Education should be ongoing.
- Education should be ongoing.

10 Lessons

#8. *A commodity exchange needs -*
COMMITTED STAFF

- Exchange staff should not only be knowledgeable and good, but should also be committed.
- Exchange staff should not only understand the benefits of an exchange, but also believe in the benefits.

10 Lessons

#9. A commodity exchange needs -
to **STAY IN TOUCH, LEARN FROM ITS
MISTAKES, BE ADAPTABLE and BE RELEVANT.**

- An exchange serves the market and must constantly re-evaluate whether it is in touch with reality
- You can only force something for so long.
- An exchange will make mistakes – learn from them and adapt accordingly
- But, do not change for the sake of change!

10 Lessons

#10. A commodity exchange must -
ADD VALUE

- The basic areas where an exchange can add value is in transparent price discovery, guaranteed settlement and price risk management.
- If value can be added more efficiently in the absence of an exchange, it will (without an exchange).
- If an exchange does not add value it will not be sustainable.

10 Lessons

- #1. Clear Objective
- #2. Enabling Policy & Good Infrastructure
- #3. Market Support
- #4. Good Systems
- #5. Rules and Surveillance
- #6. Correct Contracts
- #7. Constant Education
- #8. Committed Staff
- #9. Adaptable & Relevant
- #10. ADD VALUE

SORRY, ONE MORE!

.... a commodity exchange must
be prepared for the unexpected

