

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

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-suit to
an anonymous and
transparent
exchange

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

Raises the potential
transaction costs of
using the exchange
relative to traditional
trading

Perception that
exchange can attract
risky trading partners

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

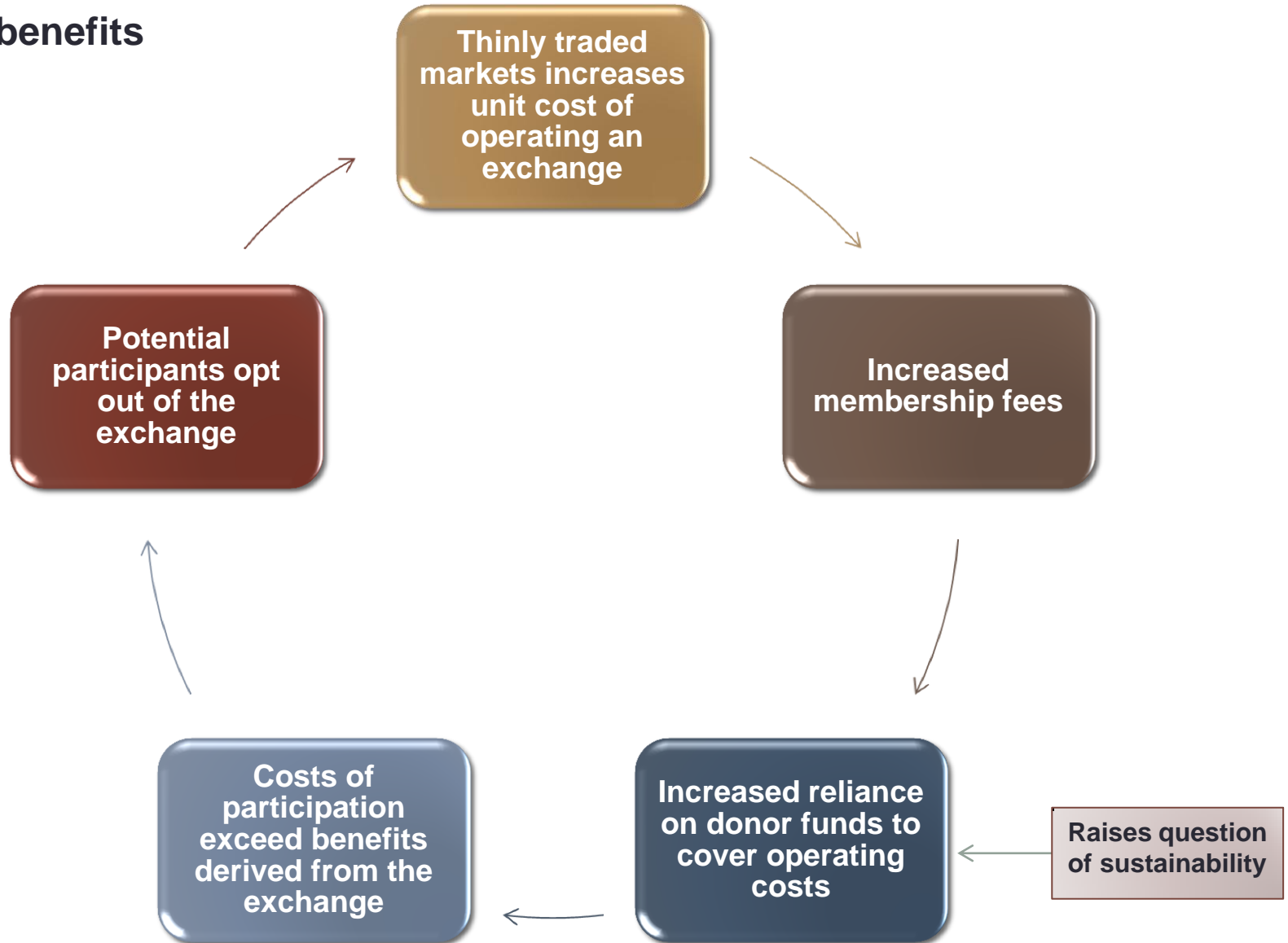
Potential conflict of interest

Limited incentives to invest in brokerage services

Exchange brokers wear two hats: broker/traders

Exchange enrolls existing market actors

Constraint #3: Costs exceed benefits



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

Small spot
market/thinly
traded
exchange

Exacerbated by high
number of
“registered “ trades:
68% of all trades
between 2008-2010

Existing
members opt
out of
exchange

Potential for
price
collusion

Deprives
exchange of
possible trade
volume

Potential
participants
remain on the
sideline

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 its 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

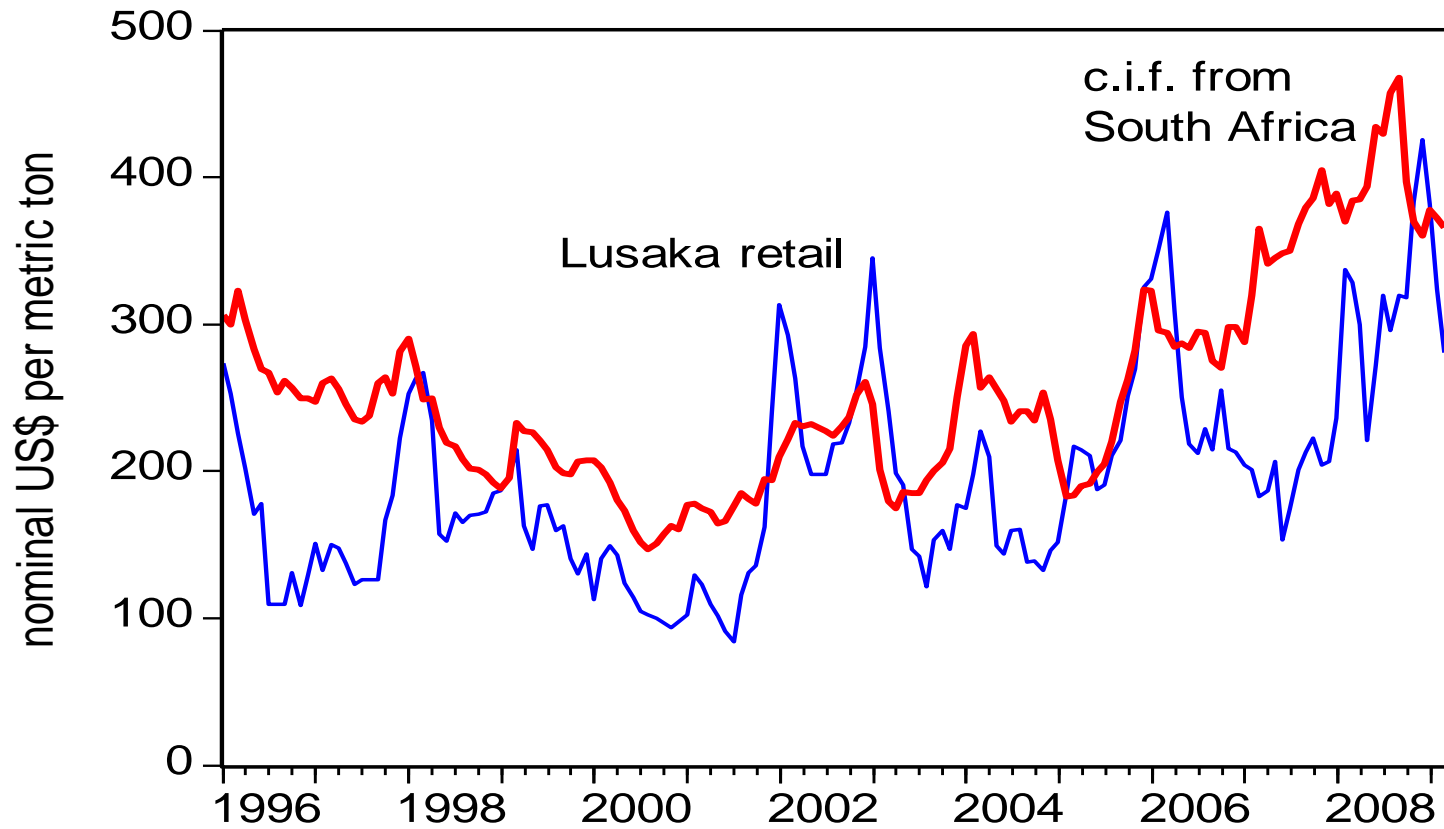
Unpredictability:

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



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
