summary PAPER

Commodity exchanges and smallholders in Africa

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1. Introduction

In 2010 the Ethiopian Government mandated that all trade in white pea beans must be conducted through the newly establish commodity exchange. To better understand how to continue working with and benefiting small scale producers in this new context, the New Business Models for Sustainable Trading Relationship project commissioned a study to look at the experiences of commodity exchanges in Africa. The overall objective of the short study was to determine the effectiveness of newly developed commodity exchanges in Africa as a means of improving smallholder farmer linkages to markets, particularly formal markets, and the advantages in terms of new opportunities, more reliable trading relationships and improved incomes, compared with traditional commodity trading routes. This study is based on interviews in 2010 in Zambia, Kenya, Uganda, Malawi and Ethiopia with many experts having a national and regional understanding of the various commodity exchange-based market reform systems.

The full paper can be found at *http://pubs.iied.org/16028IIED.html*

In order to address the seemingly intractable problems of the agricultural markets in most sub-Saharan African countries, a proposal to adopt a new system was accepted by the five countries covered by this review: Zambia, Kenya, Uganda, Malawi and Ethiopia.

The model on which this system was supposed to be based was initially almost the same for each country and was designed to tackle most of the problems that had been identified as the major impediments to a fair and efficient market system: the lack of transparency, competition, market information, bargaining power of small-scale producers, and credit in the industry, poor quality standards and inadequate volumes of production.

The theoretical model for this transformation envisaged a pyramidal structure of reforms with a commodity exchange at its apex. This exchange would be linked with a warehouse receipt system in which

- large warehouses of perhaps 20,000 ton capacity in each agricultural district would be certified by the exchange as being capable of storing goods securely,
- each parcel of the commodities traded on the exchange would be tested to see if they complied with the exchanges' quality standards,
- warehouse receipts (documents of title) would be issued, to be used by producers or traders as collateral to borrow money from banks, and traded along with physical parcels of commodities on the exchange.

At the base of the pyramid would be thousands of local depots to which typical small-scale farmers could bring their goods and find a) a qualified person to weigh and test their products, and b) small-scale traders who would compete with each other to buy the farmer's output.

In practice, the system in all five countries has drifted far from the original model, and with the exception of Ethiopia, they have failed to achieve anything like the objective that their sponsors had expected of them.

The Ethiopian system has developed very differently from the systems in the other four countries. But the four systems in the countries to the south of Ethiopia have also evolved on different lines. The Kenya Agricultural Commodity Exchange (KACE) and the Malawi Agricultural Commodity Exchange (MACE) were designed by the same people and can no longer be called commodity exchanges. Their main activity is a rudimentary market information service which collects estimates of prices and traded volumes in several wholesale centers and disseminates this information using Short Message Service (SMS), email, newspapers and some radio. The future of MACE is in doubt, as its stream of funding has come to an end. KACE can still theoretically introduce buyers to sellers, but only token quantities are traded. The Kenyan government is contemplating sponsoring a new, partly state-owned, partly private sector commodity exchange which would, presumably, take the place of KACE if the plan goes ahead. Neither KACE nor MACE is linked to a viable warehouse receipt system.

The Uganda Commodity Exchange (UCE) has also come to the end of its current stream of funding, but the government of Uganda is, apparently, trying to obtain funds to continue with the project. The turnover of the exchange is too small to enable it to cover its costs, but it is linked to a market warehouse receipt system which has been adopted by the World Food Programme (WFP) as a means to purchase locally produced food products.

MACE is in a very similar position to UCE, but it has recently boosted its turnover after the WFP decided to use the exchange in its Purchase for Progress (P4P) initiative. It uses a sort of hybrid between its traditional tendering process and a commodity exchange option to purchase food commodities.

The Zambia A Commodity Exchange (ZAMACE) has also failed to attract enough business to make it commercially viable and its sponsors now understand that it might have to be subsidized indefinitely. The exchange is owned by a small number of large trading companies who have closed membership to other interested members. ZAMACE has also attracted the business of WFP, who use yet another semi-transparent process for buying under their P4P scheme. The exchange has ambitious plans for its warehouse receipt system and a project to build many local depots around the country, but this is only at the trial stage and could be described as work in progress.

The multimillion dollar cost of all these exchanges has come from a small range of mainly US donors and covers the cost of the studies needed to establish the exchange, the exchange's buildings and equipment, quality-testing laboratories, legal work to authorize the system, diplomatic exercises to sell the idea to governments and other stakeholders, and running costs including staffing.

None of these projects was initiated by governments or any other stakeholder group (with the possible exception of the Agricultural Commodity Exchange (ACE) which was supported by a large, parastatal co-op which later withdrew its support). As one interviewee put it, they have been 'donor driven.' This is possibly the most important difference between these commodity exchange-based systems and all those similar systems that have grown organically and successfully in more developed countries, established, funded, owned and run by the people who use them.

During the several years that donors and commodity exchange employees have been making huge efforts to establish these systems, the tried and tested means of improving the market system for the millions of typical small-scale producers and traders in the industry have been neglected. None of these countries now has a universal, relevant and well funded agricultural extension service. None has a functional market information service. No assistance is given to significant numbers of farmers to help them organize themselves to undertake collective marketing which would help them to increase economies of scale and escape from their reliance on colluding local traders. There are very few programmes in existence to improve fixed place markets with proper storage and packing facilities, using standard weights, measures and packing.

It seems likely, that so much faith was invested in the new top-down, commodity exchange-based system to deliver country-wide reforms, that funding for the nuts and bolts of a basic agricultural market system has been crowded out.

If anything, the 'closed shop' of the large trading companies who control the exchanges but fail to use them enough to make them viable has reinforced the market power of these companies vis-à-vis farmers, donors and governments. Certainly, if they had wanted commodity exchanges or warehouse receipt systems, they could easily have afforded to pay for them themselves. As it stands, these companies have received useful subsidized services, such as testing laboratory facilities, arbitration services and standard contracts, from development funds. The World Food Programme now plays a decisive part in supporting these structures but has not yet used them in a way that would eliminate the role of large trading companies in its buying programme or help set benchmark prices for the goods it buys.

2. Recommendations for the four more southern countries

An independent and unbiased monitoring and evaluation exercise should be urgently undertaken to identify a workable and effective alternative to the role of commodity exchanges in this market reform programme.

The small and large warehouses needed for this market reform process will require an independent certifying body to assess and monitor the operators of the warehouses and the warehouse receipt system.

3. Ethiopia

The Ethiopian programme of commodity exchange-based reform differs radically from the others for one important reason: the government not only supports the idea, it has taken it over. Instead of focusing on grains, the government has decided that the new exchange should first set up a system to market the country's most important export commodity, coffee. And rather than leave the trading fraternity to decide whether it wants to use the new system, the government has outlawed any other means of selling coffee to the export market, with the exception of one particular case.

The huge scale of the project also separates the Ethiopian model from those to the south. Donors may have granted the project as much as US$50 million to establish and run the project.

The mandatory coffee component of the project has been judged a success by most observers. The major traders and exporters have bought seats on the exchange and have developed a system of dealing with each other to establish prices for various coffee grades and control the degree of price volatility. The existing coffee industry infrastructure of warehouses, testing centers and weighing stations has been marshalled in service to the programme.

Bolstered by this success the government has decreed that several food commodities: sesame seed, haricot beans, maize and white pea-beans, should now be allowed to be exported only after they have been traded through the exchange.

There were concerns that the necessary infrastructure and methodology would not be in place by October 2010, when the process for these new commodities became mandatory. Unlike coffee, these products have no existing equivalent development in the market structure and this will create new challenges for a major programme of Catholic Relief Services (CRS) for stimulating the production and export of new varieties of navy beans (a type of white pea-bean) which it has done by training hundreds of small-scale farmers, giving them seeds and forming a close relationship with a large Ethiopian-based exporting firm.

4. Recommendations for Ethiopia

This study of commodity exchanges was conducted to provide advice to the CRS / Sustainable Food Lab project in how best to adapt project strategy to the light of the new commodity exchange mandate on white pea beans. Given the experience of other exchanges in working with smallholders, it is clear that Catholic Relief Services should join with its partners and meet with commodity exchange and agriculture ministry officials to examine and question every aspect of the new system.

It is also vitally important that the commodity exchange identify and acknowledge as quickly as possible any failures in the system as soon as they occur. There should be some sort of crisis- management unit set up with the participation of all the stakeholder groups, and capable of either finding ways to correct problems or postponing the project if the problems prove too great to solve promptly. Some effort should be made immediately to persuade the exchange to allow such a unit to be formed.

Find the full paper at: *http://pubs.iied.org/16028IIED.html*
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