

# Commodities



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## Way to put brakes on commodity prices

GAZI TOWHID AHMED

**A**GRICULTURE experts believe a commodities exchange and derivatives market can fix the dysfunctional pricing system in rural markets. "No syndicate will be able to manipulate prices if a farmer sells his produce through a commodities exchange," said an expert.

Our productivity has increased over the last decade but most farmers remain deprived of the benefits. A major reason behind continuing poverty is the dysfunctional pricing system in the local farmers' market.

Most farmers are like helpless puppets in the hands of the powerful syndicates and middlemen. Both the farmers and consumers are victims in regards to price control and benefits reaped from agricultural products. The government has been trying in vain to curb the atrocious deliberations of the middlemen and agro tycoons.

Abdullah Al Mamun, a finance teacher at North South University and an expert in the financial derivatives market in Bangladesh, said, "A commodities exchange and derivatives market could help eliminate this syndicate and middleman menace forever."

"This market would reduce the number of middleman by establishing a direct relationship between farmers and traders," said Mamun.

He said this commodities exchange is very popular in Asian countries such as India.

Professor Mahmud Osman Imam, who teaches finance at Dhaka University, said, "A commodities market would be very helpful in halting drastic price falls of bumper harvests."

Commodity prices will remain stable if the government establishes a commodities exchange, said Osman.

Fakhor Uddin Ali Ahmed, president of the Chittagong Stock Exchange, said, "A commodities exchange would benefit the farmers as it ensures perfect pricings."

Mamun said, "In our country, it is common that after a bumper harvest, the prices of agricultural commodities, like potatoes, fall drastically."

A commodities exchange is an organised market where raw or primary products are traded on either spot or future contracts.

A commodities exchange could be able to protect crop harvests against severe price falls by selling the product in futures markets, he said.

Agricultural commodities such as corn, wheat, maize, barley, cotton, cocoa, sugar, milk, animal feed, fruits, vegetables, beans, hay, livestock, meats, poultry and eggs usually account for most of trade in an exchange.

There are two types of commodities exchanges operating around the world, such as single and multi commodities exchanges.

The single commodity exchange only trades in one listed commodity and the Multi Commodities Exchange trades in multiple commodities that are listed at the particular exchange.

A commodities exchange coordinates and unifies trading activities within a regulated and centralised system.

Every listed product has to be traded through the commodities exchange because farmers cannot sell their listed products in any unauthorised open market if a nation has commodities exchanges.

To establish a commodities exchange, a major infrastructural overhaul is necessary. Some infrastructure that need to be set up are as follows:

- Farmer's cooperative: To trade on an exchange, a farmer must be a registered member of the local cooperative. These cooperatives are not conventional cooperatives but they provide small farmers the ability to trade in his products on an exchange.

Every cooperative will have a trade account/ brokerage account, which will be used to trade their commodities on the exchange. A cooperative is also useful for farmers' education and efficiency improvement.

- Warehouse: A commodities exchange authority will also set up a chain of networked warehouses throughout the country. Every crop surplus area will have a major warehouse. These warehouses will also assess the quality and weight of the



Commodity traders at work at the New York Mercantile Exchange.

NICHOLAS WHITAKER FOR HEATINGOIL.COM

products.

After that, farmers will receive a receipt for their products. Warehouses will maintain state-of-the-art inventory management systems and follow a 'first in first out' counting system.

- Commodities rating and ticker symbol: Every commodity will be checked thoroughly by rating agencies. They will be assigned a ticker taped symbol. For example, for maize, the ticker symbol would be MZ. Traders will be able to identify the products by looking at the ticker symbol on the monitor.

- Trading floor: There will be one central trading floor where traders and brokers will meet to buy and sell commodities.

The exchange will use both 'open outcry' and electronic platform methods. The entire biddings and asking prices will be available throughout the country by sub-exchanges, remote

access terminal, short message services (SMS), interactive voice response (IVR) and ticker relay.

- Commodities clearing house: A clearing house will work as an intermediary between sellers and buyers. They will maintain all the vouchers for both spot and future trade. Buyers and sellers will receive their money and products from the clearinghouse. Disputes will be settled by the clearing house, if any.

Exchange members will maintain their cash deposits and margin money with them. Clearinghouses will be able to meet clients' obligations from the performance bond and guarantee fund.

Every commodities exchange will perform two types of trade such as spot and future trades. Most trade is spot trade, which is where buyers and sellers settle trade on the spot and same day. Both money and goods will be exchanged right away.

But commodities exchanges also specialise in derivatives trade.

Derivatives is a type of future contract that allows parties to lock in future prices. There are three types of derivatives that can be traded in an exchange --future or forward, option and swap.

Derivatives have three functions --hedging, speculation and arbitrage. Hedging reduces risk exposure, speculation makes profits based on future price movements, depending on prediction, while arbitrage takes advantages of price inefficiency in the market.

Mamun said, "I request the government to establish a commodities exchange to develop agriculture and farmers' lifestyle."

"I am ready to help the government in establishing a good commodities exchange, like in India," said Mamun.

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## Discover price through a commodities exchange

GAZI TOWHID AHMED

**A**BDULLAH Al Mamun is a finance teacher at North South University and an expert on the financial derivatives market. He expresses to The Daily Star his views on the importance of and need for a commodities exchange in Bangladesh.

*What is the importance of a commodities exchange?*

A commodities exchange is vital for an agriculture-based nation like Bangladesh. Most people in our country are involved in the agriculture sector. Even though our productivity has increased over the years, the farmers are still very poor. One of the major reasons for this poverty is our dysfunctional pricing system in the local farmer's market. Poor coordination, a lack of pricing information and broken infrastructure has created syndicates and middlemen in the agriculture market. They are making a huge amount of money by manipulating the market at the expense of farmers and consumers. A well-functioned commodities exchange will eliminate the problems with syndicates and middlemen. It will bring about coordination among the market participants through a regulated and centralised trading system.

*What are the advantages of commodities exchange?*

The commodities exchange will



Abdullah Al Mamun

help the farmers with efficient price discovery. It will also reduce the need for government intervention in the food market. Small farmers will be able to borrow money from conventional banks because it will be easier for the banks to assess risks. Customers should be able to pay real market prices for their commodities. Speculators and arbitrageurs will also help with production efficiency of the farmers.

*What are the possible disadvantages of having a commodities exchange?*

To establish a well-functional commodities exchange, it is crucial to overhaul the whole agriculture market structure. An unorganised commodities exchange will increase operational and liquidity risks in the market. A conflict of interest can reduce the effectiveness of this system. Also, we need to consider local cultures in designing the exchange.

*What would the contribution of the commodities exchange be in developing agriculture?*

Farmers will be motivated in increasing their productivity and quality if they get proper prices for their produce. When speculators take a short position on certain commodities, it sends a warning to the farmers. Subsequently, farmers take steps to rectify any problems with that specific commodity. These processes will greatly improve the overall agriculture market.

*Is this a perfect way to stop price dysfunctions?*

I do not see any other alternative to stop price dysfunctions in the market. The US had the same problems that we have today. A hundred years ago, they set up the CBOT (Chicago Board of Trade), which is a commodities exchange. It has revolutionised the life of American farmers. If they can do it, we can do it too.

*How can a commodities exchange develop farmers' lifestyles?*

Currently, Bangladeshi farmers are poor due to exploitation by syndicates and local middlemen. A commodities exchange will ensure that farmers are getting market prices for their products. If we can increase their purchasing power, it will improve their living standards.

*How can a commodities exchange help stabilise commodity prices?*

We have a decentralised commo-

ties market that is full of illicit activities. The prices of commodities are not based on supply and demand. Rather it is based on manipulation. Both farmers and consumers are losing money in this situation. Since the commodities exchange would be a centralised market place where buyers and sellers have full access to price information, it will help with price stabilisation.

*What should the government initiate to establish a commodities exchange?*

The government has a vital role to play in establishing a commodities exchange. They will make the decision to launch it. Also, everywhere in the world, it is done under PPP (public private partnership). We also need a strong regulatory authority to monitor commodity exchange operations.

*What are your expectations and demands of a commodity exchange?*

I personally believe that a commodities exchange is long overdue for an agricultural based nation like Bangladesh. Prominent Agriculture Activist Shykh Siraj also mentioned that it would be very hard to break the existing market syndicate. We have no other option but to set up an exchange to break the grip of syndicates on our farmers and consumers. I respectfully urge Prime Minister Sheikh Hasina to expedite the process.

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