

Will the ECX make farmers and traders more market savvy?

Sesame trading in Ethiopia is expected to change with the establishment of a major institutional innovation, the Ethiopian Commodity Exchange (ECX). Traders, but also farmers, might see their circumstances change in the sesame value chain during the next years. The philosophy behind the ECX is that a central and transparent market for key export crops will lower transaction costs in the value chain. It is also expected to address asymmetric information (where one party, such as traders have better information than other parties, such as farmers). The idea is to link producers more directly to international markets, and the mechanism chosen is an open outcry double auction trade floor, in the capital city Addis Ababa.

The impact of the ECX on farmers' livelihoods has still to be assessed. This study looks at the possible effects that a change in market "environment" could have on the behaviour of key agents. To do this, we conducted several experiments at village level, in which we introduced elements of the ECX: a competitive market environment characterized by public bidding, allowing farmers and traders to engage in competitive selling and buying of sesame, which is the basis of their livelihood strategy.

Farmers' market experience

The farmers in our study all are from a village near Humera, and live in a rather isolated environment. They either deliver their produce to the village cooperative, which then sells it on their behalf, or directly sell the sesame to local traders. These traders often also serve as moneylenders. Farmers therefore do not operate in a conventional competitive market environment.

Traders' market experience

When quantities traded are sufficiently large, the exchange happens through the mediation of a so-called "broker". Brokers assist the flow of various tons of sesame per year, and therefore are considered more experienced in trading than smallholders. To outperform their colleagues however, long-standing relations with clients, trust, and reputation are developed. Bargaining over prices is therefore relatively less important.

All the traders that participated in the experiment belong to this category of brokers. Contrary to traders that base their profits on the purchase and sale margins, which could be called "merchants" for distinction, brokers receive a fixed commission of 2 Birr (0,16 US\$) per quintal. Brokers often have peasant origins and limited formal education. The use of brokers in our experiment therefore limits the potential

role of other influences (such as life experiences, education, family environment, ethnical group, urban/rural origins, etc.) that will set brokers apart from farmers. In what follows, we use the terms "broker" and "trader" interchangeably.

The experiment

After filling out a brief survey, the farmers and traders were shown 8 separate sheets of paper on which 6 to 10 distinct gift possibilities were depicted (see picture below). Gifts included raw coffee beans (in unitary bags of 100 g), sugar (in unitary bags of 500 g) and mango juice (in bottles of 300 ml), all familiar, similar in price, and commonly consumed by both farmers and traders. Each participant would receive only one of the eight selected gifts. A transparent lottery process was used to determine which choice would be selected.

We tested whether farmers and traders would make market rational choices. Simply put, this is the case when farmers and traders make choices consistent with their preferences.

For instance, they indicated to prefer the gift C over gift A, but have a choice between gift A and gift B, in which B is slightly better than C. If they choose B, their choice is consistent with their preferences.



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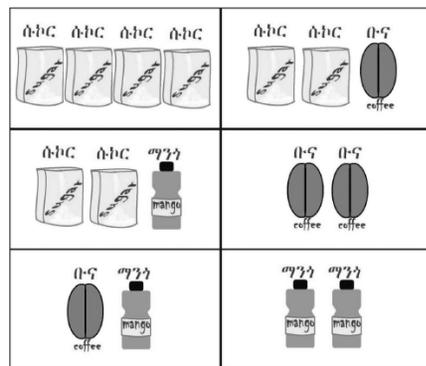
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VC4PD

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In practice, however, people often choose differently (i.e. gift A)¹ which is not consistent. It has been shown that having more experience in markets and trading reduces these inconsistencies.



Results

Such inconsistencies were indeed found in our experiment when we tested farmers and traders. We then put traders and farmers through an experience that mimicked the ECX auction trading procedures in which traders and farmers engaged in competitive bidding of 132 quintals of sesame. After the experiment both farmers and traders made more market-rational choices (i.e. showing fewer inconsistent choices). Besides, traders showed more improvements than farmers, learning more quickly.

¹ This is called a "GARP violation" in economics

Conclusions

It is surprising how a competitive market experience changed the behaviour of farmers and traders in making consistent choices. This points at the fact that the current sesame markets do not represent a competitive market system where prices are determined by competitive bidding. It also indicates that farmers and traders can adapt through time to a more competitive system.

Another surprising result was that traders changed their behaviour much quicker by making more consistent choices. This indicates that farmers who become brokers probably have more talent for business, or are more "market savvy".

Why are these results important? Choosing products that are consistent with preferences is important in making markets work. In competitive markets people are usually faced with various choices, and need to make quick and consistent decisions. If they fail to do so people will make suboptimal choices thereby losing money.

With the ECX Ethiopia is trying to establish a more efficient market environment for sesame. With our small experiment we find that if the ECX succeeds, it will indeed have positive effects on all participating agents, traders and farmers.

The ECX will lead to a market-led learning process in which different actors (farmers, traders) learn differently. This may influence the allocation of rents across groups in society, affecting the distribution of wealth. This phenomenon could have an impact also at a micro as well as macro-regional level, affecting regional growth rates. For example, while the ECX was initiated to improve the performance of the commodity value chain, an unexpected side effect may be a shift in the distribution of rents from one group of actors to another in response to different abilities to respond to incentives and margins. This poses thus new challenges to policymakers in terms of economic policy and reforms, requiring more attention to the "learning costs" of the different actors which should be considered while developing the ECX.

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