Commodity exchanges account for nearly 20% of operations involving trade in raw materials. This fact predetermines the role international commodity markets play in establishing and regulating world prices. Quotations on the London Metal Exchange determine the prices for trade in metals worldwide. Exchange quotations serve as price indicators for nearly all of the global trade in grain, cocoa beans, cotton, rubber and many other commodities. In addition, commodity exchanges act as a source of market information, including price information, for off-exchange trading. Exchange operations are actively used to hedge against commodity price volatility. The commodity exchange is not only a place for concluding transactions, but also an information centre concerning any particular traded commodity.

Nowadays, some 60–70 different commodities are traded on commodity exchanges. The production and trading of every commodity are subject to specific international regulation. This regulation is intended to balance production and international trade in raw materials. It is used to coordinate production, consumption and marketing policies and thereby smooth out sudden price fluctuations on the global markets.

Commodity exchanges have evolved from local markets trading physical commodities to high-liquidity international markets trading futures and forward contracts. They are an excellent example of a self-regulating market institute and have become an integral part of the production and financial operations of a vast number of economic entities. Whilst maintaining their original characteristics – ensuring transparency of the trading process and competitiveness in the concluding of transactions – commodity exchanges have improved technically and in terms of the number of different operations performed and contracts handled.

Development of the commodity exchange market is a spur to improving market infrastructure, credit relations and the banking system, the system of insuring against commercial risk, the cleaning and settlement system, the legal environment, and so on. These assertions are supported by research carried out by United Nations Conference on Trade and Development (UNCTAD).

UNCTAD published a number of interesting reports and studies during the first ten years of this millennium. In one publication examining the development role of commodity exchanges (UNCTAD, 2007), commodity exchanges are seen as institutions able to facilitate trade and stimulate economic growth in developing countries by reducing transaction costs along the commodity supply chain. This research suggests there is a link between activity on commodity exchanges and improvements in the wider economy. For example, the development of a warehouse network to improve the delivery and collateral management processes can substantially enhance the storage and logistics infrastructure for the traded commodities. A reliable system of collateral management – in particular warehouse receipts – provides greater security and lowers risks for banks to lend to
commodity producers, increasing the attractiveness of commodity finance as a credit instrument.

In many developing countries, according to UNCTAD research, exchange mechanisms promote the wider involvement of isolated commodity sector participants in economic relations. It should be remembered that profits are not generated merely by the establishment of a commodity exchange. The commodity exchange mechanism requires complex regulation. The role of the government within the regulatory structure is twofold. An oversight role is about preventing market manipulation and ensuring contracts are inviolable. An enabling role is about creating the necessary legal and regulatory environment and, where necessary, elements of physical infrastructure.

Regulation has three objectives: to guarantee market integrity, to uphold financial integrity and to protect investors from the malpractice or irresponsible activities of exchanges, counterparties or market intermediaries. Global commodity market experience suggests that the futures market is a highly regulated environment with a multi-layered system of oversight. The oversight these “layers” provide is often mutually reinforcing. Unfortunately, they cannot totally eradicate malpractice, examples of which periodically make the headlines.

Commodity exchanges operate in both open and restricted economies. Some were created on a wave of economic reforms, others during political transformation and the transition to free market economy. There are commodity exchanges in countries where small-scale domestic production predominates, and also in countries whose economic systems combine large-scale commercial production and small-scale producers. In some countries, commodity exchanges serve domestic markets, in others they are aimed at exports. While many commodity exchanges operate in countries where market infrastructures, institutions and procedures are highly developed, and national markets are well integrated, they have also been successfully established in countries whose markets are in need of further development and integration. Commodity exchange trading is continually developing and trading operations are becoming ever more complex. Notable trends in the sector include: a reduction in the number of commodity exchanges; the merging of specialised commodity markets into universal commodity exchanges; changes in the role and function of the commodity exchange as a financial institution; technological developments and growth in the number of commodity exchange participants; the gradual unification of commodity exchange organisations on a global scale; and changes in the way commodity exchange operations are regulated.

The revival of activity on the Russian commodity exchange was a milestone in the country’s transition to a market economy. Initially, as the command system of supply collapsed, commodity exchanges facilitated the trade in commodities. Commodity exchanges were a focal point around which investment, insurance and brokering companies, trading houses and commercial banks were founded. They also attracted capital, which was then reinvested in profitable companies and in improving IT infrastructure. Among the most important achievements of commodity exchanges has been their contribution to nurturing the first cadre of home-grown business professionals.

Despite its turbulent history, the Russian exchange sector is following international development trends thanks to its adoption of international standards and best practices.
in the operations of Russian exchanges and market regulators and the proximity of highly competitive foreign markets.

Exchange trading in Kazakhstan has still not matched the status and turnover it enjoys in the West and in Russia. The country’s commodity exchange sector is still in development. However, for Kazakhstan, as the exporting country with huge raw material and agrarian capacity, the proliferation of exchange trade is seen as viable. With the creation in 2008 of the Eurasian Trading System (ETS) and adoption of the Law on Commodity Exchange in 2009, Kazakhstan has entered a new phase in commodity trade development.

Although there are similarities between the commodity exchanges as they were developing in Russia and Kazakhstan, the differences between them are nevertheless more remarkable. One notable similarity is that both experienced a slowing down of market activity as a result of state interference. In Russia, the regulation of commodity exchanges was tightened up in 1992 coinciding with an increase in taxation and price liberalisation. In Kazakhstan, permanent revision of legislation governing commodity exchange trading has hindered the setting of a level playing field. In both countries, the state has maintained zealous oversight of stock markets in the absence of a comprehensive support programme. Another similarity between the countries is the failure to establish the same level of infrastructure and regulation for commodity exchanges as exists for the stock market.

The final part of this report presents the results of research undertaken jointly by the Eurasian Development Bank (EDB) and the International Association of Exchanges of the CIS (IAE CIS) on commodity market regulation in Russia, Kazakhstan, Belarus and Ukraine. Research has shown that regulation of commodity exchanges in Russia, Kazakhstan and Belarus is hindering interexchange cooperation on organised commodity markets. It is now time, research suggests, to define and adopt priorities for the development of an organised interstate commodity exchange. This will require a more detailed analysis of the problems that affect such cooperation; it also calls for the development of a long-term strategy to create a competitive interstate commodity market. It is clear that the differences in legislation regulating organised commodity markets and trading activity are a serious stumbling block to interexchange cooperation. As already mentioned, the regulation of organised commodity markets lags far behind that of the stock markets or the banking sector. Legislation needs to be drafted which takes into account fully the specific characteristics of an organised commodities market.

It has been suggested that the results of comparative analysis of the regulation of organised commodities market in CIS countries be used to develop a comprehensive commodity exchange model for CIS member states and the SES, based on common principles of operation, provision of access to professional participants, regulation of trading floor procedures and size of assets, information transparency, contract guarantees and risk management.

A large number of issues will need to be addressed in order to achieve the necessary level of legislative unification between the member states. This will require collaboration between regulators, commodity exchanges, industry association (IAE CIS) and other interested parties. A special oversight authority dedicated to the sector should be created to coordinate development efforts in the organised commodity market, similar to those established for the stock markets in the CIS and EurAsEC regional organisations.