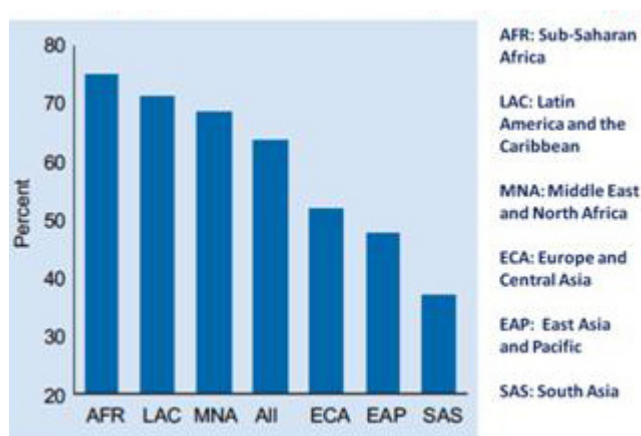




don't blame mother nature¹

As my World Bank colleague Milan Brahmbhatt and I observed in a recent note (BRAHMBHATT; CANUTO, 2010) primary commodity exports remain crucial for most developing countries. When one takes a simple average across developing countries (i.e. attributing each country an equal weight) for 2003-07, commodities still show up as accounting for over 60 percent of merchandise exports, with half of the group featuring a commodity export dependence of over 70 percent. Chart 1 shows different degrees of primary commodity dependence across regions.

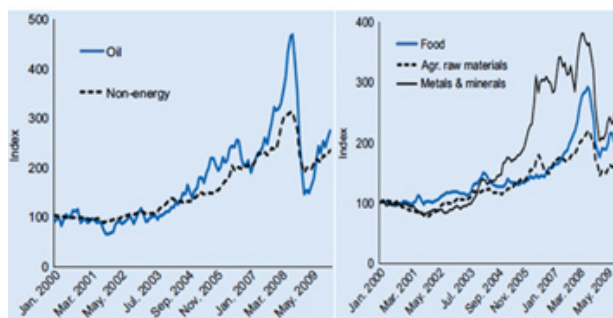
chart 1 - developing countries: commodity exports share of merchandise exports (simple average)



Source: Brahmbhatt and Canuto (2010) [1].

Therefore, the prospects for most developing countries during the current crisis have varied in accordance with the evolution of commodity prices. The rally initiated in the second quarter of 2009 (Chart 2) came sooner and stronger than many expected, notwithstanding the fact that the intensity of the previous downward swing was such as to lead one to expect a strong upward swing once the recovery was in place. Both the pace and timing of the commodity price surge were in contrast with past experience with cycles (HELBLING, 2009).

chart 2 – commodity price indexes – jan 2000 - nov 2009 (US\$ 2000 = 100)



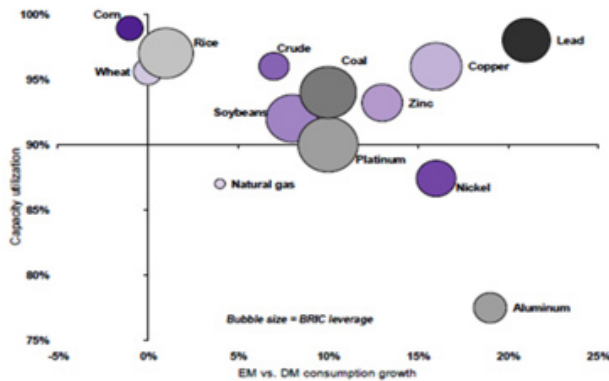
Source: Brahmbhatt and Canuto (2010).

As is the case for other risky assets, commodities benefited from the perception that the worst of the recession had been left behind, as a result of the wide-ranging public-sector responses to high uncertainty and systemic risks. The leading role in the global recovery played by emerging Asia also led to an upbeat forward-looking assessment of the demand for commodities. Furthermore, the liquidity available for financing and hedging of inventory positions has remained abundant and inexpensive as a consequence of “reflationary” policies adopted in developed countries.

What about the horizon beyond the immediate future? First of all, one should not lose sight of the differentiated trajectories of commodity prices (even at aggregate levels such as in Chart 2). It all depends on how commodity-specific long-term productivity growth performs relative to that of non-commodity sectors, technical and political barriers to expand capacity, and income-elasticities of demand. Chart 3 illustrates how differentiated supply constraints currently are for different commodities, as well as the weights of (dynamic) Emerging Markets (EM) relative to (stagnant) Developed Markets (DM) in their demand. According to Goldman Sachs (2009):

“the more binding the constraints on investment and supply growth and the more leverage to emerging market demand, the stronger the commodity price recovery has been this past year and the stronger the outlook is into 2010 and beyond”.

chart 3 – commodity differentiation driven by supply and EM exposure

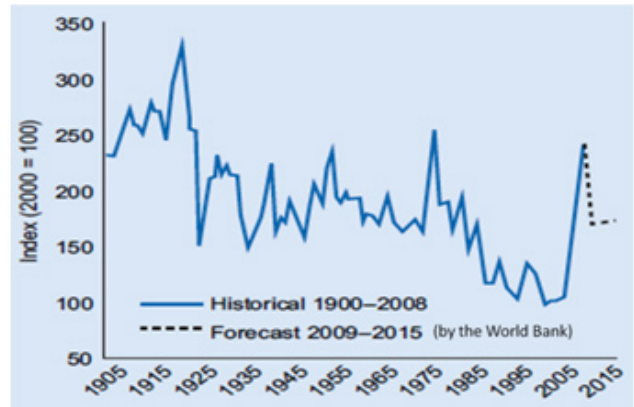


Source: Goldman Sachs, “Commodities – 2010 outlook: resource realignment”, 12/03/09.

As Milan and I argue in our paper, we have little reason to expect real commodity prices to trend either up or down in the long run. It is quite possible for commodity prices to move significantly lower or higher for substantial periods even in the absence of a long-run trend or drift - see Chart 4. On the other hand, as a general attribute expected for most commodities, relative demand for commodities is likely to rise in the medium term, as world growth after the financial crisis is more dependent on developing countries and demand in these countries is more commodity intensive than elsewhere. There are both supply and demand factors that could support the present relatively high level of real commodity prices, although these factors will tend to dissipate in the longer term.

Are the prospects of high commodity prices a blessing – or a curse - for commodity-dependent countries? The answer is... it depends both on commodity-specific features and on the quality of governance and public policies.

chart 4 – real non energy commodity prices – 1900-2015*



Source: Brahmhatt and Canuto (2010) [1]. * Indexes, 2000=100. Deflated by unit value of manufactured exports

Even assuming that impacts of higher prices of some commodities on local poor households (such as high food prices) are compensated for, there are several ways by which higher commodity prices may hurt a commodity-dependent economy. For instance:

1. The well-known Dutch Disease effects: the increase of commodity-related income may lead to excess demand for – and price hikes of - non-tradables, and thus ultimately to real exchange-rate appreciation. The country may then end up worse off in the long run if economic sectors with higher capacity of supporting growth and social inclusion are negatively affected.
2. Commodity prices are volatile and higher commodity-dependence may mean higher volatility of fiscal revenues and/or real exchange rates, with the resulting uncertainty damaging investment. Deleterious effects of that volatility are higher if price booms tend to be accompanied by over-borrowing.
3. Depending on the features of the appropriation and use of rents generated by the increase in value of natural resources, rent-seeking (rather than efficiency-seeking) behavior may become the norm.

As Milan and I note, it is worth distinguishing among commodities. Oil and minerals – concentrated “point source” resources that can easily become the object of rent-seeking and redistributive struggles (including armed conflict) – are more prone to generate problems of the first and third type than, for instance, more open and competitive agricultural commodities. See also Collier and Goderis (2007).

In any case, the actual extent of Dutch Disease, volatility, over-borrowing etc. can be reduced with cautious macroeconomic policies that moderate aggregate demand pressures, smooth volatility effects in government budgets, and curb over-borrowing. The creation of sovereign-wealth and anti-cyclical funds may help in that regard, while also making possible the preservation of country net worth as depletable resources are exhausted.

Good governance and responsible fiscal policies can do much to avoid a predominance of rent-seeking behavior. With respect to the former, the role and influence played by international investors is obviously of the essence.

Bottom line: Mother Nature neither blesses, nor curses. Policies and institutions are what matters.

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1 The views expressed herein are those of the author and do not necessarily reflect the views of the World Bank Group. Originally published at <http://blogs.worldbank.org/growth/don-t-blame-mother-nature-1>

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