Discussion of Session 2: The new supply and demand issues in commodity markets

China, commodity prices and the terms of trade (Raphael Kaplinsky)

Commodities still in crisis? (David Sapsford and Stephan Pfaffenzeller)

Comparative analysis of organization and performance of African cotton sectors: learning from reform experience (Colin Poulton and David Tschirley)

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Comments: full agreement, just additional questions and complexities…

R Kaplinsky points
- Since 2002 commodity prices have risen beyond their historic trend
- **They will be sustained in the near/medium-term**, and even the long-term.
- Questions the previous debates on the (barter) terms of trade
- The two major Asian Drivers – China and India – representing a **disruptive force in the global political economy**.
- Asian Drivers’ demand pushes the prices of hard commodities, agricultural products and fuels.

**Question: will the terms of trade reversal be sustained?**

Yes…

FIGURE 1: CRUDE OIL PRICES (US$ per barrel)

Source: World Bank

Source: Baffes 2007
BUT…

Source: The Economist 15th April 1999
C Poulton-D Tschirley points

Cotton prices: decline
Problems of low productivity in WCA.

Tension stakeholders: maintaining input credit, extension vs. donors focusing on efficiency.
Failing input, credit markets => more coordination,
vs. efficiency => more competition

Political dimension of the issues, explaining resistance to reform, esp. in West Africa. Resistance also explained by a very mixed impact of reforms on sector performance, esp. on small farmers (in West SSA).

ESA: outcomes of privatisation and liberalisation of the cotton sectors very mixed....

=> despite their intrinsic problems (characterising developing countries, e.g. “state failures”), public policies, institutions, state intervention: crucial for the efficiency and allocative roles of the cotton sector.
1. High commodity prices, perhaps for a long time: but will it change one of their key characteristics, i.e. volatility?

- Key issue for low-income countries, esp. SSA: well-known negative effects of volatility
- Loayza et al. (2007): macroeconomic volatility has much higher welfare costs for poor countries than for rich countries. Chicken or the egg? Macroeconomic volatility more frequent in developing countries than rich countries.
Figure 3. Volatility of Terms of Trade Growth (regional medians)

Source: Loayza et al. 2007
Figure 2. Macroeconomic Volatility and Economic Growth

Source: Loayza et al. 2007
Negative effects of volatility compounded by the current context of global trade openness.

Loayza and Raddatz (2007) on the structural determinants of external vulnerability, WBER: greater trade openness magnifies the output impact of terms of trade shocks, particularly negative ones.

Negative impact even worse for oil-exporting countries (as underlined by Kaplinsky: agricultural commodities to be distinguished from fuels)

IMF SSA Regional Economic Outlook (April 2007): the share of fuels has risen to over half of total SSA exports.

IMF SSA REO (October 2007): terms of trade have improved, but above all for oil exporters.

Olters (2007, IMF): fiscal management very difficult in oil-exporting countries. oil prices are highly volatile => permanent threat for the fiscal balance.

= Angola, Cameroon, Chad, the Republic of Congo, Côte d’Ivoire, Equatorial Guinea, Gabon, and Nigeria)
Figure 1.5. Terms of Trade in Sub-Saharan Africa

Terms of trade have improved for oil exporters.

Sources: IMF, *World Economic Outlook*; and IMF, African Department database.

Source: IMF SSA Regional Economic Outlook 2007-October
Source: from Olters (2007)
Causes of high commodity prices are multiple:
not only global demand (China), but also financial:
Commodities are alternative financial assets (Helbling et al. 2008, IMF) e.g.,
exchange rates, interest rates, inventories, speculation, etc. (Frankel, Roubini)
E.g., August 2008: oil prices have started to decline.
E.g., Monday 15 Sept.: drop in the price of oil and cotton, due to Lehmann Bros.
bank bankruptcy: integration of global financial and commodity markets.

IMF WEO Sept. 2006: the key problem of global business cycles: demand for
commodities vary according the different stages of growth of emerging countries
(e.g. oil, copper, steel, etc.)
=> contributes to the volatility of global demand.

WB GEP 2007: SSA too reliant on commodity exports=> it is the region most
vulnerable to any decline in energy and mineral prices.
SSA oil and mineral exporters the most vulnerable to commodity price
volatility.
The structural characteristic of primary commodity prices remains high
volatility

Cf WB: e.g., Saba Arbache and Page (2008): is Africa’s Recent Growth Robust?
Real Oil and Non-Oil Commodity Prices

Source: Streifel (2006)
Source: Streifel (2006)
2. A key issue: high commodity prices may have negative effects: maintaining the distorted market structure of commodity-exporting low-income countries

- Well-known excessive dependence of low-income countries on commodities for exports

- Here, ambiguous effects of the removal of subsidies in rich countries (e.g., cotton) (as they increase international prices)

- **Exports = primary commodities since the colonial period:** 95.3% of SSA exports = primary commodities in 1980 (oil and non-oil). In 2005, food = 15% of merchandise exports; agricultural raw materials = 5%; fuels = 36%; ores and metals = 10%; manufactures = 33% (WDI 2007).

- **SSA did not diversify the export structure despite decades of IFI programmes: little structural change.**

• Associated problems: **export concentration:**
  • often **only one** agricultural product, often maximum 3 agricultural products:
  • e.g., Mauritania exports 13 products, Angola 13 products, Congo 30 products, …..
  • To be compared to, e.g., 221 for Ireland or 214 for Portugal) (Jansen 2004).

• Associated problems: obstacles to, no incentives for industrialisation:

• e.g.: UNIDO Industrial Development Report 2005: **in 1990, SSA = 0.79% of world industrial output;**
• in 2002, 0.74 %.
• If South Africa excluded, **in 1990, SSA = 0.24% of world industrial output.**
• In 2002, 0.25%…..
<table>
<thead>
<tr>
<th>Commodity</th>
<th>Country</th>
<th>Share in total exports</th>
</tr>
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<tbody>
<tr>
<td>Aluminium</td>
<td>Suriname</td>
<td>47</td>
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<td>Tajikistan</td>
<td>46</td>
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<td></td>
<td>Guinea</td>
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<td>Mozambique</td>
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<tr>
<td>Cocoa</td>
<td>Côte d’Ivoire</td>
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<td>Coffee</td>
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<td>Copper</td>
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<td>Chile</td>
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<td></td>
<td>Mongolia</td>
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<tr>
<td>Cotton</td>
<td>Burkina Faso</td>
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<td>Benin</td>
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<td>Fish</td>
<td>Iceland</td>
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<td></td>
<td>Seychelles</td>
<td>30</td>
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</tbody>
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Source: IMF WEO Sept 2006: Table 5.1. Dependence on Exports of Selected Non-fuel Commodities (2000–04; in percent)
Figure 1: Africa's Share of World Exports

Source: Subramanian and Matthijs (2007)
• Commodity dependence may generate (poverty) traps

• UNCTAD: SSA commodity-dependent countries caught in a poverty trap. Fast-growing manufactures are technology-intensive, in sectors with high productivity growth - though fallacy of composition applies to manufactures (Kaplinsky, Ramzi, Blecker).

• Nexus= dependence on commodities, low productivity, low value added, high competition in their main sector of activity, concentration of exports in a few products.
• For UNCTAD: volatility: key factor of poverty traps: SSA oil-producing countries particularly exposed.

• Same for the IMF: ambiguous impact of a growth driven by global demand: growth or ‘lock-in’ effects in the commodity market structure, in a primary products trap?

• Indeed, since the mid-2000s, high growth in SSA. IMF Regional Economic Outlook (April 2008): in 2007, real GDP = +6.5%, driven by global growth and demand (in Asia, exports to China), high price of oil, minerals, metals, global demand for commodities => ToT have improved in SSA.
3. Impact of China?

- Yes: spectacular increase in trade between China (and India) and SSA, investment, aid.

- IMF (Wang and Bio-Tchané, 2008): between 2001 and 2006, SSA exports to and imports from China rose on average by 40% and 35%,
- higher than the growth rate of world trade (14%)
- or commodities prices (18%).

- China = SSA 3rd largest trading partner, after the US and the EU.
Rising demand

Increased demand, especially in emerging markets, is a key factor pushing up prices of commodities.

(Contributions of selected regions to annual consumption increase; period average)

Sources: U.S. Department of Agriculture; World Bureau of Metal Statistics; British Petroleum; and IMF staff.

1 Metals are in hundreds of thousands of metric tons. Major food crops—corn, rice, soybeans, and wheat—and oil are in thousands of metric tons.

2 Major food crops are corn, rice, soybeans, and wheat.

Source: Helbling et al. (2008), Finance and Development (IMF)
Figure 1: Number of African Countries Exporting Natural Resources to China

Source: Meyersson, Padró i Miquel and Qian (2008)
Figure 2: African Exports of Natural Resources to China over Time

Source: Meyersson, Padró i Miquel and Qian (2008)
But the composition of goods traded between SSA and China is similar to that between SSA and its other major trading partners:

- in 2006, oil and gas = 60% of SSA exports to China; nonpetroleum minerals and metals = 13%.
- Africa’s imports from China = manufactured products, machinery, transport equipment (3/4th of total imports).

IMF: similar composition of goods traded between SSA and its main trading partners

=> the recent surge in SSA-China trade reflects partners’ comparative advantages given their stage of economic development and not China’s unilateral quest for natural resources.

China is reproducing the long-standing SSA pattern – export of primary commodities – more than modifying it.

cf. IMF WEO (Sept. 2006): the rise of China may change long-term price trends; the world has entered a period of sustained high prices;
- prices may however continue to decline in real terms, as during the past century.
- Despite recent increases, the prices of most nonfuel commodities remain below their historical peaks in real terms, compared with the prices of manufactures.
- **China’s impact = uncertain at the economic and political levels.**

- **A positive process, increasing prices and exports.** Kaplinsky (2006): price changes in the 2000s reverse the decline in the ToT of commodity producers in SSA. The entry of China into the global market augments the demand for commodities. Cf Zafar (2007): China’s demand for natural resources has contributed to a rise in prices (for oil, metals), and boosted real GDP in SSA.

- **But pessimism.**
  - High commodity prices: detrimental effects on SSA political regimes: **they reinforce autocracies, rents, fuel civil conflict** (as shown by Kaplinsky, McCormick and Morris 2007).….  
  - **China’s demand reinforces the specialisation of SSA in commodity exports**, increases its dependence on natural resources, reduce incentives for diversification.  
  - **China: negative impact on SSA manufacturing sectors**, which cannot compete with the low production costs, technology, cheap goods from China (ending of the MultiFibre Agreement in 2005 => devastating impact on SSA textile sectors, cf Kaplinsky).  

- **Bardhan (2005): “China, India Superpower? Not so Fast!”**…..
4. But exporting primary products *per se* – commodity dependence - is not the only cause of poverty traps (or low equilibria)

- Composition of exports reflects underlying structural features and endowments: e.g., in labour, human and physical capital.

- There are **strong complementarities between factors, which limit the possibilities of changing production and export structures.**

- *E.g., skills per worker, or land per worker* (Owens and Wood, 1997), demography, geography, etc.

- **Poulton-Tschirley and Kaplinsky papers, revealed by A Maizels:**

- = above all, the key role domestic political economy, of public institutions

- Shown by the differential performances and reaction to reform of SSA cotton sectors (Poulton-Tschirley).
Confirm the findings of the founding fathers in development economics…

Rosenstein-Rodan (1943): coordination failures = key factors of underdevelopment.

Coordination necessary in the early stages of development - agricultural contexts, lack of capital - as it reduces costly competition.

Spillovers induce increasing returns to an activity proportional to the number of other individuals who undertake the same activity or complementary ones.

Absence of spillovers => multiple equilibria and underdevelopment traps.

Justification of the role of the state at the early stages of development

The state = the only entity able to reallocate factors and resources across markets.

50 years later: market structures of most SSA countries = ‘traps’ with low innovation and inefficient institutions (Hoff, 2000).

Institutions as crucial causes of traps.

Bowles (2006): concept of ‘institutional poverty traps’: why have institutions that implement highly unequal divisions of the social product been ubiquitous since the very beginning of social organisations, and why do they persist even in those cases where they convey no clear efficiency advantages over other feasible social arrangements.
5. Concluding remarks: the difficulty of regulating commodity prices, volatility (fuels, agric – cotton- etc) in a context of global trade openness and financial integration

A) The 2000s: the end of “markets against states” – the end of the “counter-revolution” of the 1980s (J Toye, I Adelman):
- e.g., Fanny Mae, AIG: even in the richest nation-states, public institutions, policies = the only entities able to smooth the domestic detrimental impacts of international markets (financial, goods).
- **State, meta-institutions**: necessary to the correction of the intrinsic detrimental effects of unregulated markets: A Maizels arguments…

B) High prices: not so good news..
- In states relying on the export of commodities: 2 sides:
- **the international side**: their vulnerability to international markets: volatility of international prices, for their fiscal balance: for geopolitically weak developing countries, **need for meta-institutions**: able to coordinate policies, pool resources (even private US banks are currently building a reserve fund…)
- **The domestic side**: taxation, institutions: how to smooth this volatility
C) Also, not so good news, due to political economy problems: in developing countries: states are weak; further weakened by IFI reforms, trade openness.

Question: causalities?

does commodity export dependence => weaken states further: or weak states => locked-in commodities. Cf Rodrik on strong states necessary with openness.

Many theories, so-called ‘resource curse’, conflicts, etc. vs. commodities do not cause lower growth per se: cf Blomström and Kokko on Scandinavian countries.

Institutions matter. Cf Englebert on Congo, Isham et al. on ‘point-sources’: oil, coffee, more harmful than other agricultural commodities.

Question: are countries with weak political economies able to form coalitions – cf A Maizels -, and reduce vulnerabilities?
- **Political economy matter**: i.e. *external political economy*: ability of governments to make the appropriate deals (ex. states with geopolitical power, capacity for negotiation, e.g. Russia with oil, gas; China with oil, etc.)

- **+ internal political economy**: governments oriented towards growth – as did Asian developmental states in the 1970s: i.e. provide incentives towards domestic growth to private firms, banks, investors, trading firms, etc.

  - **capacity to overcome the negative impact of trade openness**: cf Kaplinsky on textile sectors in SSA affected by Chinese imports.

- **These conditions are rarely met in low-income countries:**

- Well-known **endogeneity between low growth and ‘weak’, fragmented institutions, threshold effects:**

  - The new importance of commodities may weaken low-income countries (corruption, capital flight, inequality): cf oil countries, but not only.. (cf cocoa, etc).

- **Natural resources are not ‘fate’**.

- **But global demand for commodities**: negative effects on political institutions which in turn perpetuate low diversification, vulnerability, ‘**institutional traps**’.
Earnings from natural resources (oil, minerals) accrue to governments: authoritarian regimes enjoy leeway vis-à-vis the IFIs conditional financing
windfall gains compounded by aid from China (India, Brazil)
= countries outside the ‘cartel’ of usual donors (Easterly, 2003), driven by trade interests, securing energetic needs, inputs for industries.

When resources are primary resources: no necessity to expand the economy: contrast to Asian developmental states: authoritarian governments used export-led growth as instrument to enhance legitimacy (Kang, 2002 on Korea).

‘Low equilibria’, institutional traps here likely to stabilise.
=> Uncertain political economy effects of the demand for commodities

Low income commodity exporting countries at a tipping point:
= being locked in a low-equilibrium vs. higher equilibrium (S Bowles, K Hoff).

The surge in commodities prices attracts foreign investments and financing => spillover effects, industrialisation,
or intensify the specialisation in the production of primary commodities: it reinforces political economy ‘low equilibria’: difficult to get out.