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journal homepage: [www.elsevier.com/locate/jie](http://www.elsevier.com/locate/jie)Revisiting the commodity curse: A financial perspective<sup>☆</sup>Enrique Alberola<sup>a</sup>, Gianluca Benigno<sup>b,\*</sup><sup>a</sup> Bank for International Settlements, Americas Office, Mexico<sup>b</sup> London School of Economics, United Kingdom

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## ABSTRACT

We study the response of a three-sector commodity-exporter small open economy to a commodity price boom. When the economy has access to international borrowing and lending, a *temporary* commodity price boom brings about the standard wealth effect that stimulates demand and has *long-run* implications on the sectoral allocation of labor. If dynamic productivity gains are concentrated in the traded good sector, the commodity boom crowds out the traded sector and delays convergence to the world technology frontier. Financial openness by stimulating current demand, amplifies the crowding out effect and may even lead to a growth trap, in which no resources are allocated to the traded sector. From a normative point of view, our analysis suggests that capital account management policies could be welfare improving in those circumstances.

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## 1. Introduction

The commodity cycle starting at the turn of this century has reversed in the last years. The boom phase in commodity prices has contributed to boost growth and economic performance in resource rich economies, but the reversal has severely impacted their growth rates.<sup>1</sup>

Commodity prices are characterized by longer cycles (of around thirty years or supercycles, see – Erten and Ocampo (2013)) than overall business cycles. Since 1960 (IMF, 2015) two supercycles can

be identified in the energy and food sectors: one from the mid-seventies to the end of the nineties and the current supercycle which peaked around 2010. The length of the commodity price cycles suggests that shocks in this sector are persistent but they might eventually reverse.

In this paper we re-examine the link between commodity booms and resource allocation by emphasizing the international financial dimension of this interaction. Our focus is in understanding how the access to international financial markets shapes the allocation of resources within an economy subject to commodity price cycles.

Indeed, the impact of commodity booms on resource rich economies has a long tradition in economic analysis. More precisely, the commodity resource curse or Dutch disease underscores the perverse impact that a positive commodity shock may have on the economy.

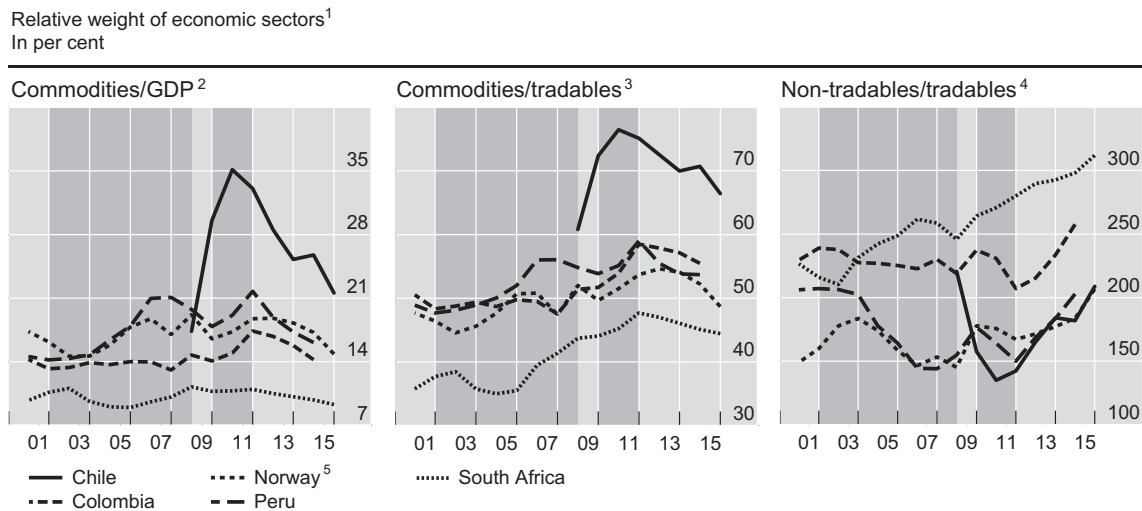
An increase in commodity prices represents a positive terms of trade shock that pushes up domestic relative prices and income. The increase in internal relative prices negatively affects the rest of the tradable sector and increases domestic demand, both of tradable and non-tradable goods. As a result, there is a reallocation of factors out of the tradable sector and into the commodity sector and the non-tradable sector. Corden and Neary (1982)

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<sup>1</sup> A recent study of the importance of commodity price fluctuations for emerging market economies is from Fernandez et al. (2015).



<sup>1</sup> Shaded area represents commodity boom periods. <sup>2</sup> Commodity sector includes agriculture and forestry, fishing, mining and quarrying and oil and gas extraction. All when applicable. <sup>3</sup> Tradable sector is the sum of commodity and manufacturing sectors. <sup>4</sup> Non-tradables include rest of economy which comprises mainly services: electricity, gas and water; construction and dwelling services, retail, accommodation, communication, transport, storage, courier services, financial services, business services, personal services, government, arts, health care services, defence, real estate. All when applicable. <sup>5</sup> GDP and sectorial GDP valued at basic prices.

Sources: National data; BIS calculations.

Fig. 1. Relative weight of economic sectors.

provided the seminal model to analyze this resource reallocation of factors and the process of de-industrialization in a simple framework.

The deeper meaning of the disease from the commodity booms is that they can also inhibit long term growth. However, absent some form of frictions, this relocation of resources would be entirely efficient and the Dutch disease wouldn't really constitute a "disease". The idea that the manufacturing sector is the driving force of the economy and that de-industrialization can lead to an impoverishment of the country is supported by the notion that resource-rich economies tend to show lower growth rates than economies endowed with few natural resources. For this to happen, there should be differential productivity dynamics among sectors and the sectoral reallocation induced by the commodity shock must hamper the ability to attain the productivity gains from technological development for the economy as a whole. This outcome hinges on two assumptions: i) faster productivity growth in the tradable sector relative to the other sectors of the economy and ii) the presence of (stronger) externalities in the tradable sectors.<sup>2</sup>

The perception that commodity booms can generate a misallocation of resources that impinges negative on growth is well entrenched and has been present in policy debates in commodity

rich economies during the ascending phase of the cycle and, more intensely, when the cycle has reversed.

Fig. 1 shows the evolution of sectoral ratios since 2000 for a subset of commodity exporters (shaded areas represent periods of high commodity prices). While the share of the commodity sector relative to total GDP and the rest of the tradable sector increases during the boom period, the ratio of non-traded goods over tradeable suggests a decrease in the relative importance of the traded sector following the recent decline in commodity price.<sup>3</sup>

While the reference model of *Corden and Neary (1982)* assumes a financially closed economy (i.e. trade balance is always in equilibrium), the dynamics of external accounts have gathered less attention in the academic literature on commodity shocks. In practice, the concern about the fallout of the commodity cycles has been increased by the evolution of external positions in commodity exporters, which is displayed in Fig. 2.

In a financially open economy, after a positive commodity shock, the exports of tradeable are expected to decline and a higher overall domestic demand of tradeable can be satisfied by higher imports. The trade and current account balances impact is, in principle, undefined as the worsening of the tradable balance could be more than

<sup>2</sup> The most widespread intuition to explain this outcome is that a large share of the tradable goods is manufactures, which tend to enjoy higher productivity growth, as they are more prone to convey technological progress than other sectors. As a result, a commodity price boom may reduce the ability to grasp the productivity gains from technology and depresses long-term growth. Theoretically, this result is built into models through the introduction of dynamic productivity gains (by spillover, or by a learning-by-doing effect or increasing returns to scale) in the tradable sector of the economy.

<sup>3</sup> However, the evidence on Dutch disease is mixed (see *IMF (2015)*, box 2.1 for a survey), both on the sectoral reallocation and on long-term growth inhibition. Older studies (*Spatafora and Warner (1995)*, *Bjørnland (1998)*) find no evidence of a reduction in manufacturing following the commodity boom, and the latter actually finds that sector benefited in Norway from oil discoveries and high prices. More recent evidence, using more disaggregated data (*Ismail (2010)*) tends to find more support for the reallocation hypothesis. Regarding long term growth, the evidence is elusive, too (see the survey by *Magud and Sosa (2013)*).

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