Foreword

Global economic development has long been propelled by the mass production and consumption of raw materials—for food, energy, shelter, and all the comforts of modern civilization. Even as the human population quadrupled over the past 100 years, global commodity markets kept the world well stocked and supported poverty reduction and better living standards.

Amid overlapping crises over the past two years and the ongoing transition to lower carbon intensity, commodity markets are being reshaped. COVID-19 highlighted the volatility of these markets: global shocks can boost or drop prices sharply and suddenly, with destabilizing consequences for developing economies. The war in Ukraine has made the security of energy and supply chains a more prominent goal, even if it entails higher costs. Efforts to reduce greenhouse gas emissions are shifting demand away from fossil fuels while increasing demand for the metals and materials needed to build solar and wind infrastructure and battery storage. The sudden disruption of natural gas markets, which have often been providing electricity base load during peak demand, brought new concerns about grid stability, grid capacity when adding intermittent renewables, and a global return to coal and diesel electricity generation.

This book offers a comprehensive analysis of major commodity markets and analyzes how changes in these markets affect the economies of developing countries. Over the next three decades, the growth of global demand for commodities is likely to decelerate as population growth slows, with many developing economies maturing and shifting their demand mix more toward consumption and services. The energy transition is likely to bring a major boost to metal-producing economies because technologies related to renewable energy tend to be more metals-intensive.

The ongoing transformation of global commodity markets will have profound implications for countries that depend on commodity production for economic growth, exports, and fiscal revenues. Countries that depend on commodities account for half of the world's extreme poor. But the report suggests there may be differentiation among exporters: fossil-fuel exporters could see a decline in revenues while metals exporters reap windfall gains as the energy transition proceeds.

The book sheds new light on the causes and consequences of commodity market volatility. It shows that commodity-price shocks tend to have asymmetric effects. This could in part be driven by the nature of (often non-transparent) export contracts. Price increases don't materially boost the economic growth of commodity exporting countries, but price declines significantly reduce their growth, sometimes for several years. As a result, policy solutions need to be tailored to each country's circumstances and characteristics. This finding highlights why policymakers should use upswings in commodity prices to prepare for the next downturn. Policymakers can choose from three sets of instruments to mitigate or manage commodity shocks:

- *Better fiscal, monetary, and regulatory frameworks*. Commodity-price swings often spur governments to adopt policies that aggravate boom-and-bust cycles, ramping up government spending when commodity prices rise and keeping spending high even when prices and government revenues fall. Governments should put in place a fiscal framework that builds rainy-day funds that benefit from export surges and can be deployed quickly in an emergency. This would add to the stability of currency and monetary systems, which are key ingredients in attracting investment and raising living standards. Regulators have to guard against the accumulation of excessive financial-sector risks—especially those that accompany non-transparent capital inflows and foreign-currency debt.

- *Avoidance of subsidies and trade restraint*: Governments tend to resort to subsidies or trade protection to reduce the effects of commodity-price movements on consumers. Commodity-exporting countries often try to mitigate market volatility by reaching agreements to regulate supply. History shows that such efforts are always costly and usually counterproductive. A better approach is to adopt market-based risk mechanisms to reduce exposure to price movements; and targeted safety nets to protect the poor.

- *Economic diversification:* Commodity-market risks are greatest for countries that depend on the exports of just a few commodities—especially fossil fuels. The risk of a climate-related secular decline in fossil-fuel demand argues for diversification. Similarly, low-income countries that depend too heavily on exports of agricultural products would benefit from reforms that encourage diversification into other sectors. In both cases, the key first step is to avoid subsidizing exports, given the fiscal cost and volatility risk. A wide range of structural measures can help encourage economic diversification: building human capital, promoting competition, strengthening institutions, and reducing distorting subsidies. The record is clear: An economy's long-term growth prospects and resilience to external shocks usually improve as it allows diversification beyond commodities.

For sound global development, the next few years are critical in adopting policies that allow rapid growth in median income and the income of the world's poor. Inflation and commodity market volatility have contributed to the reversals in development in recent years, undermining poverty reduction and the energy transition. Over time, demand for commodities will have to be met by greater productive capacity—either through technological advances or the substitution of one commodity for another. A sound goal is for the shifts in commodity markets to encourage good outcomes for both development and environmental sustainability. All countries have a shared interest in acting promptly to defuse the risks of stagflation, slow growth, and environmental harm. This book provides some of the key information needed to act on that interest.

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