

## Introduction

### Background

The antecedent to the present work is Marian Radetzki's book, *A Guide to Primary Commodities in the World Economy*, published by Blackwell in 1990. In that book Radetzki presented the gist of what he had learnt during twenty five years of active study and research on international primary commodity markets. The timing of that publication was clearly inopportune. Although the book received positive reviews, it aroused only limited attention. Through the 1980s and 1990s, primary commodity markets were in the doldrums. Supply conditions for most commodities were quite relaxed most of the time, and prices remained suppressed. The advanced economies were in a process of dematerialization, where declining volumes of raw materials were needed per unit of value added. This suppressed demand growth and reduced the significance of commodities in their macroeconomies. In these circumstances, security of supply assumed a low priority for users. Producers struggled with excess capacity and weak profitability. Speculators' interest was muted by the relative market calmness and declining prices. Noncommercial investors like pension funds and mutual funds had little incentive to engage in longer term commodity placements. These actors, instead, directed their capital flows to fields like information technology and sophisticated services, where markets appeared to provide a better profit potential.

Against this background, interest in commodities dwindled among public policymakers and media, but also in the academic community. Researchers found more fertile ground for their efforts in other sectors of the economy, while students' attention went elsewhere. Commodities were simply not a rewarding career area.

This situation changed dramatically a few years into the present century, when the most powerful and unusually enduring commodity

boom began. Prices of most commodities in all categories, fuels as well as minerals, food products, and agricultural raw materials, exploded. Existing production capacity, dilapidated by years of negligence due to low prices, could simply not satisfy the speedy demand expansion resulting from spectacular economic advances in the emerging world, with China in the vanguard, passing through an especially commodity-intensive phase of their economic development. Earlier attitudes of complacency among consumers were replaced by worries about security of supply, with the realization that ample availability of commodities is indispensable, and that even prosperous dematerializing economies cannot survive without safe raw material inputs. Producers of commodities, in contrast, experienced an unexpected and extraordinary profit surge. Investments in capacity growth were stimulated by the high prices, to the extent of exhausting the immediate availability of investment inputs.

The rising commodity prices galvanized the managers of hedge funds, pension funds, and other capital portfolios to invest in commodities, both as a means of diversification and for the prospect of significant profit opportunities. Speculators also reentered the commodity markets on a large scale.

From 2005 onwards, primary commodities became truly hot stuff, with current events in the commodity markets regularly displayed on the first pages of newspapers and magazines, and figuring prominently on TV screens. 2008, in the midst of the commodity boom, was then a highly opportune time to see a second edition of Radetzki's book, this time titled *A Handbook of Primary Commodities in the Global Economy*, and published by Cambridge University Press (the first edition for this new publisher).

The exceptional prices of most commodities persisted for a few more years after the book's publication, the constant price indexes for each major category reaching a peak in 2011. Substantial price falls have since been recorded, as massive new capacity, whose establishment was triggered by the boom, went into production, while at the same time the explosive global demand expansion was suppressed by a sizable downward adjustment in the economic growth pace of China and several other emerging economies. In consequence, by January 2015 the price index of all primary commodities was 40% below the peak of four years earlier.

*An Opportune Time to Publish*

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January 2015 was also the time when Cambridge University Press approached Radetzki about a new edition of the *Handbook*. 2017, the planned publication date for this edition, may have been slightly less exhilarating than 2008, but there is little doubt that a number of exciting stories worthy of sharing with a wider audience have emerged since the previous edition, and many of them are included in the present expanded opus. To mention just a few: The dominant role of China as commodity consumer has only recently been fully acknowledged; price transparency has been greatly improved by the relentless progress of commodity exchanges; resource nationalism has been on the rise, stimulated by the high prices of past years; and the emergence of shale oil and shale gas has given a new perspective to fuels markets and on sustainability and depletion.

There is dual authorship this time. Radetzki, having reached an impressive age, invited Linda Wårell, a knowledgeable and versatile colleague professor at Luleå, to share the workload, and her acceptance has undoubtedly contributed to a broadened and refreshed treatment of the problems.

**An Opportune Time to Publish**

The recently ended drama of the commodity boom and the ensuing spectacular price falls have maintained a strong interest in the primary commodities universe among public policymakers, captains of industry, and scholars, amongst many others. The contribution of the primary resource industries to GDP may be small, but there is now a clear perception that primary commodity supplies are indispensable to progress, despite decades of dematerialization and increasing dominance of the service sector in the rich world. Despite a growth deceleration, the emerging world continues to expand speedily through development phases of high commodity intensity, and this assures continued steady commodity demand growth. The publication of a broad-based book on primary commodity markets in the international economy, therefore, appears appropriate and important. This is especially so since, to our knowledge, no such book has been published since 1990, when Radetzki's old opus first appeared.

The text which follows provides a comprehensive overview of pertinent issues relating to primary commodities in the global economy.

The basic structure of earlier editions has been retained because we believe that it continues to be valid and appropriate. Major components in that structure cover:

- The geography of commodity production and trade;
- The distortions of production location and comparative advantage caused by protectionist trade policies;
- The institutions of price formation; the causes of short-run price instability and long-run price trends; the role of commodity exchanges;
- Fears of and measures to ensure the importers' supply security;
- Prospects for successful monopolistic producer collusion;
- Trends in and implications of public ownership;
- Issues raised by a very high national dependence on commodity production and exports.

So much has changed over the past decade that a mere updating of the old text was completely inadequate. All the above themes have therefore been thoroughly rewritten.

New portions have been added providing further detail to cover what was formerly overlooked or to explore newly emerging phenomena. The additions comprise:

- A completely new chapter on fossil fuels, to reflect the great importance of fossil markets among commodities;
- The geographical shift of the center of gravity in the world economy and in primary commodity consumption from the prosperous OECD nations toward the populous developing Asia;
- The changing directions of the global trade flows, with developing countries greatly expanding their exports of manufactures and losing their dominance as net exporters of raw materials;
- The recent role played by China and India as consumers of imported primary commodities;
- The increasing reliance on commodity exchanges, providing valuable opportunities for stabilizing hedging, but at the same time widening the scope for speculative activity and financial investment in commodity markets;
- The new and more relaxed attitude toward depletion, where peak oil or peak gold and peak copper have lost their urgency;
- The revival during the 2000s decade of the popularity of nationalization and state ownership in some resource-rich countries and industries.

The subject of primary commodities in the global economy is vast, and not all its aspects can be treated within the confines of a single tome. Our focus is on the economics of commodity production and trade in a somewhat narrow sense, while issues related to, e.g., employment, skill creation in the sector, or regional development do not receive any detailed attention in the following chapters.

## The Readership

The subject treatment is firmly based on standard economic theory and economic logic. But we have consciously avoided technical jargon and algebra. Readers with only basic training in economics should therefore find the text fully accessible.

Despite the omissions mentioned above, the book offers a comprehensive survey of the commodity world in the international economy, and we are aiming at a broad readership. While experts in a particular aspect of that world will probably not gain any substantive new insights in their specialization, we are convinced that reading this book will provide them with a valuable context from which to pursue further work in their chosen field.

The categories of readers that should find the book of interest comprise:

- Students in economics, finance, business administration and related disciplines, with an interest in primary commodity markets. Researchers who have chosen a specific commodity or a specific commodity-related issue as their area of specialization, who desire a snapshot overview of the entire commodity economics field;
- Executives responsible for marketing or investment decisions in firms that produce and export primary commodities;
- Executives responsible for purchase management strategies and their execution in firms whose production relies heavily on raw materials inputs;
- Members of the financial community with an interest in primary commodities for the purpose of speculation or as an object for financial investment. Such individuals would be found on the commodity exchanges and in organizations that manage capital portfolios, like hedge funds, pension funds and mutual funds, but also in financial institutions, e.g., investment banks, that develop and market instruments for commodity placements;

- Government officials in nations heavily dependent on primary commodity production and exports – Chile, Peru, Botswana, Ghana, Mongolia, and Papua New Guinea provide examples, but there are many more. Government officials in countries that rely heavily on commodity imports ought to have an equally strong interest in the analyses presented below. The latter country group would comprise China, the EU, Japan, and the USA;
- Finally, the book should find many additional readers among the broad general public concerned about rising prices and the future availability of commodities.