Commodities: Power to the People or Power to the Government?

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World economic growth has always been accompanied by short term cycles along its trend. Structural changes – as those we have seen for the last 20 years associated with the entry into the world market economy of a late half of it - mostly affect the first; monetary policies, transitory price shocks or baseless panics, the second ones. As of now, expansive monetary measures taken by the Federal Reserve and then the ECB will guarantee the "shortness" of the recent episode and the return to a natural long term growth path.

Commodities prices are obviously affected by world long term growth path and short term cycles, besides their own specific market considerations, which usually include cartel practices. Among commodities, oil and its substitutes in the energy sector are by far the most important ones. Last year, oil averaged close to US$ 100 per barrel – in contrast to US$ 35 average since 1946 in current US$, or US$ 37 for the last 20 years, or almost trice historic values - and the world consumed approximately 85 million barrels per day. That means that the total oil market in 2008 was close to US$ 3.1 trillion. Given that oil represents 35% of world primary energy, being the rest coal, natural gas, nuclear and hydroelectricity, the energy market had transactions valued at approximately US$ 8.8 trillion, or 16% of US$ 54 trillion world GDP at current US$[1]. No wonder the importance of these markets, for their impact in the world economy is huge, more so when their worldwide economic weight more than doubled within a short time period.

By comparison, world copper consumption was close to 18 million tons in 2008 and its price averaged US$3.15 per pound, valuing the market at US$ 125 billion, or 4% of the oil market or a little over 1% of the energy market. Its average price for the last 20 years was US$1.8 per pound in current US$, or approximately half its maximum value in 2007[2].

Similarly, the "lightness" case is also valid for food commodities, such as wheat. Its total world consumption amounted to 634 million tons and its price averaged US$ 326 per ton in 2008, creating a US$ 207 billion market, or less than 7% of the oil market o slightly over 2% of the energy market for that same year. Its average price for the last 20 years was US$ 205 per ton in current US$, or 63% of its peak value of 2008[3].

In other words, price variations have been much more pronounced in the recent past in the oil and energy markets than anywhere else. Much of this relative trajectory is probably related to more effective cartel practices in those markets and further artificial inflexibilities – many times, regulatory ones - that get particularly priced when being under short term stress due to faster world economic growth. Moreover, in terms of economic importance, the other commodities do not really count. The real income redistribution the world witnessed during the last years was from those that were energy deficient to those that were not.

It so happens that the energy sector is particularly distorted and cartelized and frequently attached to governments, through direct ownership or higher tax rates. In this sense, the purse that really grew up was primarily that of energy exporting governments. Furthermore, even their own people lost income, and only via reimbursements along time from their central governments they could receive part of this worldwide wealth transfer. Needless to say, energy deficient countries – both government and people – hugely lost.

On a worldwide basis, this pronounced commodity cycle temporarily meant the power of the purse was transferred to governments. Not a good idea. If we want that power back under a long term horizon, only competitive markets could effectively control these wealth (and power) transfers, improving at the same time permanent growth capabilities. The most important step people could take is to once and for all challenge this market full of anticompetitive distortions and not wait for our governments, which we have seen do not even dare – or it is not in their interest - to challenge OPEC and their like. The rest is obvious: open all energy markets, enforce competition and make new technologies like pacific nuclear reactors available to all. Governments are supposedly set up for policies that try to improve long term growth and guarantee minimum standards of living, specially focused on the poor ones, but not for the control of people's purse. If we are to have a credible competitive policy, we might better start with one of the biggest and notoriously imperfect industries.

Paradoxically, being an energy deficient country such as Chile meant that what its people lost in terms of energy costs in this commodity cycle was recovered by the central government purse as taxes from private copper mines and state mining properties that also enjoyed higher prices. But when the cycle starts reversing for all commodities, the gains from lower energy values to people could be even higher relative to the government loss of copper revenues. Between 2005 and 2008, total government copper revenues moved between 5% and 8% of GDP[4], relative to a historic 1% or less. The excess energy expenditure, relative to a US$ 50 per barrel of oil, reached a peak in 2008 within that range too. But even if income effects were to be equivalent, there would remain one big difference, which is who determines the use of resources, the people or the government, and when.

We the People prefer a more effective control over governments, their purses and ours. However, it is quite interesting to realize how this imperfect energy market continues as it is, even with all its wealth and power consequences. The energy market transformed itself into an uncompetitive tax substitute source and it need not be so. The world would be much better off breaking up this cartel. Beware of domestic energy participants that follow this path, apparently backed by a generalized disruptive behavior beyond the frontier. They too are liable.

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[1] Both GDP and oil consumption figures are assumed to be equal to 2007; World Bank and BP Statistical Review of World Energy for 2007.

2 Cochilco - Chile

3 USDA -US

4 Dipres - Chile Finanzas Publicas and Cochilco - Chile