Pacific island commodity prices

Graeme S. Dorrance and Maureen Liu

Services, including government expenditure and agricultural production for domestic consumption, including subsistence agriculture are the main sources of income in the South Pacific countries. However, exports, foreign aid and emigrants' remittances are important sources of variation in income. That is, to a degree, the island economies are more dependent on international transactions than is indicated by the ratio of foreign receipts to domestic incomes. Aid is largely a product of long-term foreign government or international agency decisions and therefore not subject to large short-term variations, except for special cases such as the current Papua New Guinea program[1] (in these instances it tends to be a stabilizing factor).

Remittances from Pacific islanders living abroad also tend to be relatively stable, based on the levels of New Zealand, Australian, American Samoan and United States incomes, but again varying in a stabilizing pattern with local crises such as the recent inflow to Western Samoa to help relatives recovering from cyclone Ofa.

Other than dramatic incidents such as hurricanes or the closing of the Bougainville copper mine, receipts from commodity exports is the most highly variable factor in the Pacific economies.

Changes in export receipts are the product of changes in export volumes and export prices. Export volumes tend to be largely determined by trends reflecting the development of the economies, other long-term influences such as the ageing of coconut palms that are not being replaced because copra prices have experienced long-term declines, and short-term catastrophes such as hurricanes. Insofar as export outputs respond to price changes, the volume responses tend to be proportionally less than the price stimuli and take place after the change in price signals. As a result high production is delayed until after the peak of prices and continues to be high into the price troughs.

In the South Pacific countries, stabilization schemes based on moving averages of prices lengthen the price response lags so that production tends to peak when prices are at their lowest and vice versa. Price stabilization schemes usually achieve their main purpose of reducing the fluctuations in producers' export incomes, but achieve this by tending to lower exporters' average incomes.

The Pacific islands produce a very small part of the total world output of the products that they export. Even the closure of the Bougainville copper mine (a large one) produced a minimal decline in the world's copper production. Hence, any changes in Pacific island output will have a very small effect on the international prices of their exports. Pacific island exporters must accept world prices that they cannot influence. In technical terms, they are 'price takers' rather than 'price makers'. Consequently changes in international prices are important determinants of short-term changes in Pacific islanders' welfare. With the beginning of production at Porgera (the world's largest and, currently, the lowest cost mine) and Misima, Papua New Guinea may cease to be a price taker and become one of several price makers for gold. Even so, the gold price is likely to be much more influenced by the erratic shifts in demand than by changes in supplies.

During the latter part of 1989, commodity prices generally tended to decline, with some overall recovery in the first part of 1990. This recovery was short-lived as expectations of a deceleration of the rate of increase in output, or even of a recession, in the industrial countries gathered strength (Chart 1). Any stimulus from the possible growth in demand arising from the Iraqi operation was overshadowed by the depressive effects of the rise in petroleum prices, that, by mid October

1 See 'Current economic trends in selected South Pacific countries' in this issue.

were more than double their levels of a year earlier. In late October, oil prices were falling slowly as output expanded in other countries. However, all the prospects for 1991 suggest that there will be little, if any rise in commodity prices. On the other hand, further serious declines appear to be unlikely.

Base metal prices have followed a markedly different pattern than that for food prices (Chart 2). While food price indexes are dominated by grain prices that have been restrained by European and United States subsidies, several Pacific island commodities (cocoa, coffee and copra) have been subject to specific price restraining influences. Papua New Guinea would have benefited from the rise in copper prices that led to the increase in the metal price index, if Bougainville had not closed. For several years at least, the new mines (Porgera and Misima already in production, and Mount Kare, Lihir and Hidden Valley) will produce relatively little copper, but will add to gold output. Aside from nickel production in New Caledonia, relatively small gold production in Fiji and possible developments in the Solomon Islands, there is practically no other mineral output in the South Pacific.

Despite a slowing of construction and a decline in automobile output in the industrial countries ***copper*** prices rose in the second half of 1990 after declining in the first half of the year (Chart 3). This was largely the result of an increase in Japanese demand that was encouraged by a review of the world's base metals supply by the Ministry of Trade and Industry (MITI) indicating that a shortage of metals such as copper, leading to price increases, might be expected. Continued labour problems in Peru and the loss of Bougainville output also exerted upward pressure. Very low levels of stock holdings by metal exchange merchants were offset by rising holdings by metal users, so that inventory effects on the price were minimal. With demand forecast to rise by 1.5 per cent per year over the next decade (MITI), the price should remain firm, but could well drop in the near future as supplies are expected to rise by 3 per cent in 1991, but stabilize thereafter.

A dramatic rise in the demand for stainless steel, particularly in Japan (that is difficult to explain), and practically no change in supplies of ***nickel***, caused a sharp drop in manufacturers' inventories and an increase in its price from US$8300 per tonne in December 1989 to US$9100 per tonne in October 1990. New Caledonia was the Pacific country that benefited most from the rise in base metal prices.

The structure of ***sugar*** prices is an example of the nonsensical effects of the European Community's Common Agricultural Policy (CAP) and the US Farm Support Program. The European domestic price is maintained to support the comparatively inefficient European producers. It is paid for all sugar produced in Europe and for a limited amount imported from developing economies that are signatories to the Lomé Convention—the African, Caribbean and Pacific (ACP) countries. Approximately half of Fiji's exports are sold to the United Kingdom under this arrangement. The United States pays a similar high price (but less than the ACP price) to US producers and for limited quota imports primarily from Latin America and the Caribbean.

The high CAP price encourages European production in excess of Europe's needs less the imports under Lomé. These excess supplies plus all production not benefiting from Lomé or US quotas are sold on the international market. The excess ACP production is not only a drain on the Community's budget but lowers the price available to the more efficient developing economy (and Australian) producers. The ACP and US prices remained

Chart 1 **International indices**
(1980 SDR value = 100)

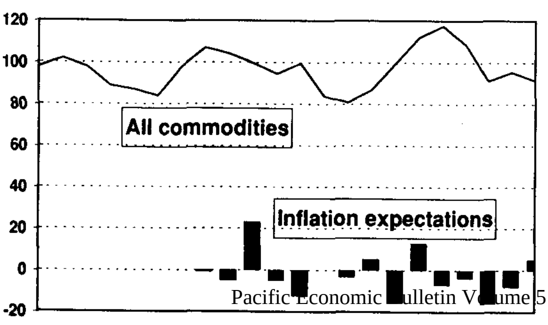
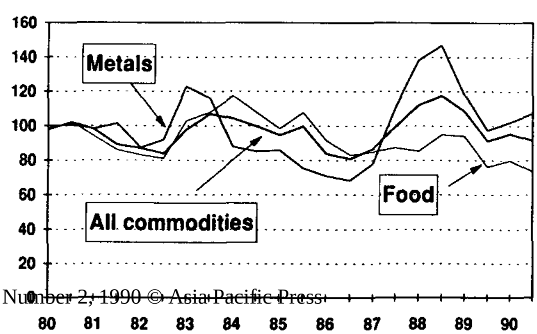


Chart 2 **International trade price indices**
(1980 SDR value = 100)



high through 1990 (Chart 4). The 1990 US Farm Bill raised prices slightly and provided for possible further increases to meet rising costs. Declines in Chinese and Russian purchases were primarily responsible for the decline in the international price (that determines the price for approximately half of Fiji's exports). The international price fell through 1990 to levels that had not been touched since mid 1987 but which were well above those prevailing in the early 1980s. At present, inventories of sugar are well below those usually associated with low prices. In terms of annual world consumption, they are even below those at the time of scarcity in 1980–81. A rise in Russian or Chinese consumption and developing economy demand, responding to lower prices, could well lead to an upsurge in sugar prices.

A large number of price support arrangements have collapsed and been followed by extended periods of low prices for the products that were subject to price stabilization (the International Tin Agreement, the OPEC cartel, the Australian Wool Board floor price etc.). The International Coffee Agreement (ICA) price support arrangement, that had to be suspended in July 1989, was an example of such a project. Since then, ***coffee*** prices have been at historically low levels in constant-price terms. In June 1990, arabica (the type grown in Papua New Guinea) prices were approximately 30 per cent of their ICA floor levels. Since June, they have risen by over one-third in SDR terms. Brazil's 1990 production was less than expected. It is forecast that 1990–91 world production will be less than consumption. A further reduction in already depleted inventories should provide upward pressure on prices, particularly arabica prices. The ICA quota system is to be reconsidered before September 1992. It is not impossible that, with rising free market prices, a new unsustainable floor price will be agreed upon, laying the basis for the stimulation of excessive investment with consequent price collapses and bankruptcies similar to the one now facing one of Brazil's largest coffee exporters—Inter-Continental de Café.

The International Cocoa Agreement remains in force with a policy of maintaining the already high buffer stocks in the face of an expected 7 per cent excess of world ***cocoa*** production (2.40 million tonnes) over consumption (2.25 million tonnes). In the early months of 1990 prices rose in response to dry weather in Brazil and the Ivory Coast. In June, rain in both countries changed the forecasts, and prices returned to close to their 1989 record low levels. Until there is marked disinvestment in cocoa production, or a drastic (and almost impossible) increase in consumption, the longer term prospects for cocoa prices must be pessimistic. There may be small rises as in mid 1990, but little prospect of a return to the levels prevailing in most of the 1980s.

Copra prices are almost as low as they have been at any time since the mid 1986 trough and the outlook is most uncertain. 1990–91 soybean production (the world's major source of vegetable oil) is lower than in 1989–90, but the US Farm Bill provides further support for soybean planting. Sunflower and rapeseed (other competitors for coconut oil) production is up. Palm oil (a more direct competitor for coconut oil) production is up, but Indian consumption is rising rapidly. Preferences appear to be shifting from soybean and corn oil towards palm, peanut and coconut oil—the aggressive and somewhat misleading anti-cholesterol propaganda in favour of US produced oils appears to be losing its effectiveness. A 1990 drought in the Philippines is likely to reduce coconut output so that the total world supply of copra is expected to decline by some 4 per cent in 1991. On balance, copra prices may be expected to

Chart 3 **Mineral price indices**
(1980 SDR value = 100)

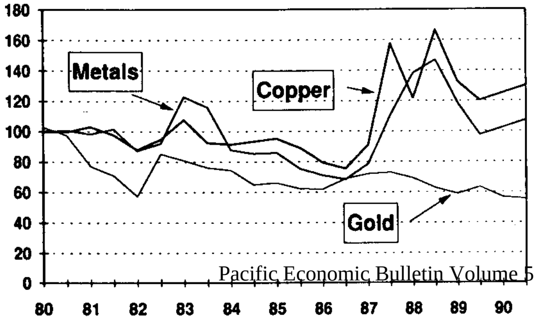
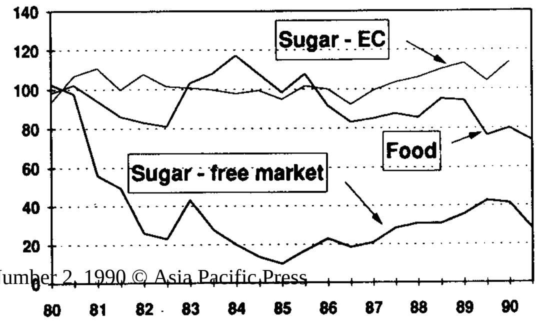


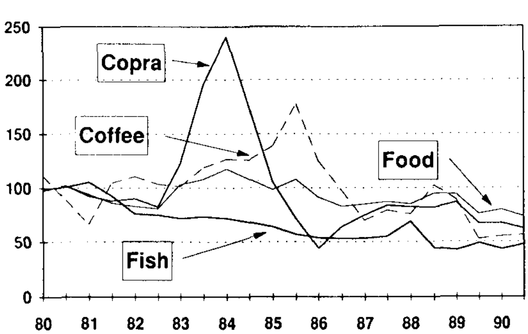
Chart 4 **International sugar price indices**
(1980 SDR value = 100)



rise in 1991 from their present depressed levels that are creating problems for many of the Pacific islands. However it is almost certain that they will not return to anything like their 1983 levels in the near future, or (in constant-price terms) ever. Copra production is much more likely to be a long-term declining industry than an expanding one.

In early 1990, ***tuna*** prices were declining as a consequence of an essentially short-term increase in supply from driftnet fishing. In the second quarter, policies were adopted by the United States to discourage fishing in the Eastern Pacific to protect dolphins. This encouraged fishing in the Western Pacific. The decision to reduce, but not eliminate, the number of Japanese driftnet boats in the South Pacific[2] will also, in the short-run, reduce the supply of fish. Consequently, prices moved upward in the second half of the year. A continued increase in demand, that could be effectively increased by improving and enlarging unloading facilities in Japan, should sustain and even lead to further price increases in 1991. The royalty proceeds, as distinct from direct sales, of the Exclusive Economic Zones (EEZs) are expected to increase in 1991 and 1992. Negotiations to renew the US agreement which expires in 1992 have started. The Forum Fisheries Agency is negotiating an agreement with the EC that is expected to lead to an increase in payments to the island governments that will be less than the $60 million received under the US agreement, but still substantial.

Chart 5 **International food price index** (1980 SDR value = 100)



Concern over the ecological effects of logging has resulted in restrictions on log and ***timber*** exports from a number of countries, with the result that prices have been rising. Continued conservation pressure and the depletion of tropical hardwood forests should lead to further reductions in supply, with consequent increases in price.

Gold moved within a range of US$350–US$420 (SDR 270–315) per troy ounce in 1990. It reached a high point in February and moved downwards until the Iraqi crisis, tending to recover slowly and erratically thereafter, but not yet reaching its end 1989 level. The volatile nature of the market is exemplified by the US$25 decline in one day as a result of a sale by one organization (the National Commercial Bank in Jeddah). It is reported that there is a well organized syndicate of Middle Eastern bankers manipulating the market and profiting by the daily price gyrations. As gold prices tend to move in response to changes in speculative demand, rather than the proportionately smaller changes in supplies and consumption that are typical of other commodities, they oscillate over a much wider range than most prices. Nevertheless, long run production and consumption flows are basic determinants of prices. For the immediate future, the world's supplies appear to be reasonably stable— increases in Papua New Guinean production should offset the continued decline in South African output. Unless there is an unexpectedly severe recession 'industrial' demand is likely to rise. The demand for jewellery, that is increasing, will require more than the total world output (in countries other than Russia) unless there is a severe worldwide depression. This increase will more than offset an expected small decline from the electronics industry. On balance, any likely supplies from Russia and possible declines in official holdings of gold reserves can probably be absorbed by industrial demand. It is surprising that the Iraqi crisis has had a minimal effect on gold markets. The current range of prices US$375–US$400) is comfortably above the long-run marginal costs of production (usually considered to be US$350), and well above the operating costs of the more profitable mines (Porgera's running costs are reported to be US$80–US$100 per ounce). The prospects for 1990 seem most likely to point to small upward pressures on prices, with fairly large (2–5 per cent) speculation-inspired daily movements, but no dramatic changes. However, the gold market has a long record of surprising seemingly well informed observers.

2 See 'Japan's cooperation with the South Pacific region' in this issue.