

Global Economic Prospects

HIGHLIGHTS from SPECIAL FOCUS FROM COMMODITY DISCOVERY TO PRODUCTION: VULNERABILITIES AND POLICIES IN LOW-INCOME COUNTRIES¹ *Global Economic Prospects January 2016*

Key Points

- *Major resource discoveries have transformed growth prospects for many low-income countries (LICs).*
- *Weak commodity prices have led to concerns about delays in transforming these discoveries into actual production.*
- *Such delays are creating macroeconomic vulnerabilities in the pre-production period.*
- *Improved governance and sound macroeconomic policy, however, can reduce production lead times in the medium term.*

Falling commodity prices may cause resource development delays. Surging commodity prices during the 2000s spurred growth and resulted in a spate of commodity discoveries in several LICs. However, the turn in the “commodity supercycle” has begun to disrupt mining production in some countries (for example, Dem. Rep. of Congo, Guinea, Sierra Leone, and Zambia). There are risks of delays in major mining and energy projects under development in East African LICs that could affect growth prospects.

Vulnerabilities accumulate during development delays. Depending on the commodity and the size of the discovery, countries can accumulate sizeable vulnerabilities as investment rises and external liabilities grow during the lead time between commodity recovery and extraction. Project delays prolong the period of heightened vulnerabilities and delay the boost to growth that is typically associated with production. For the largest metal deposits, a price downturn in the early stages of development, when licenses and extraction rights are negotiated, could potentially delay development by a few years. This could be critical for some LICs with growing fiscal and current account pressures.

Improved governance is associated with shorter development delays. While lower commodity prices could lengthen lead times (between discovery and production) for copper mines, their effects can be mitigated by policy reforms. For instance, had the average LIC had the same “quality

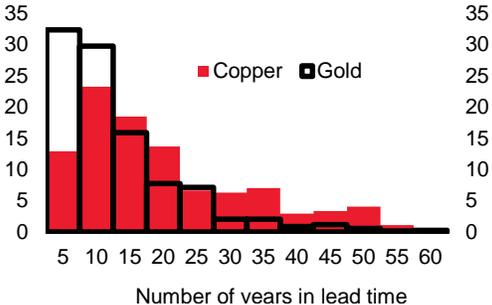
¹ This Special Focus was produced by Trang Nguyen, Tehmina Khan, Franziska Ohnsorge, and Richard Schodde.

of government index” or the same “control of corruption index” as Chile or Namibia, the lead times for the development of copper discoveries since 2000 might have been shortened by as much as two years (see Figure D). Sound macroeconomic policies, such as low public-debt levels and low inflation, appear to be similarly beneficial.

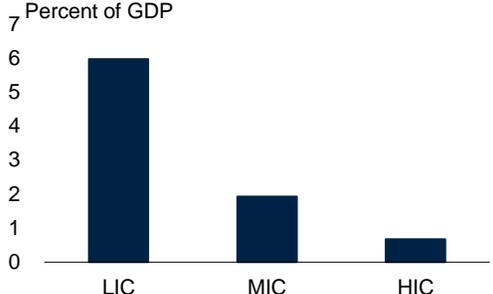
Policy options depend on the stage of development. Many LICs remain at the frontier of resource exploration and are expected to be major sources of commodities over the long term. Countries at the initial stages of resource development could consider accepting further delays if it is a source of vulnerabilities and reduces the long-term risk of “stranded assets.” Where development is already far advanced, this option may be unattractive. In these countries, especially, improvements in business and macroeconomic environments could offset some of the price pressures on resource development. At the same time, they would benefit non-resource investment and help reduce macroeconomic vulnerabilities.

Figure 1: Lead Times, Role of Commodities and Macroeconomic Vulnerabilities
Lead times from discovery to production can be significant for some commodities. Resource production can be sizeable compared to the economic size of LICs and middle-income countries. Between resource discovery and production, vulnerabilities can increase as has been the case for some East African LICs. Lead times to production can be shortened by improving business environments.

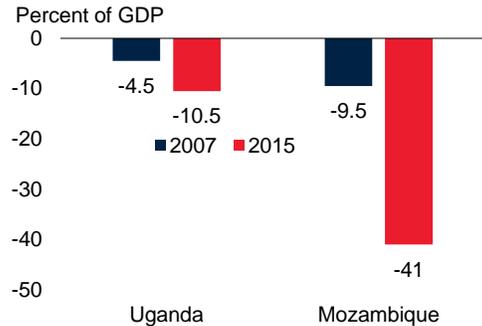
A. Time from discovery to production



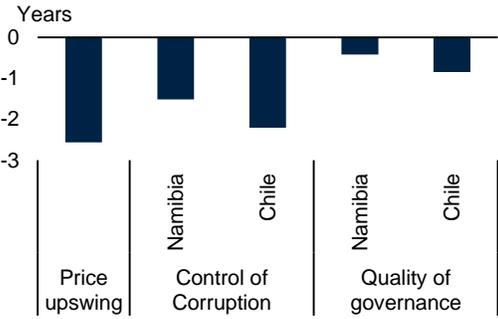
B. Copper exports, 2014



C. Current account deficits in selected East African LICs



D. Reductions in lead times for average LIC copper mines: three scenarios



(Download chart data to Excel)

Sources: World Bank; International Monetary Fund; MinEx Consulting; ICRG; World Governance Indicators.

B. LIC refers to low-income countries, MIC to middle-income countries, and HIC to high-income countries.

D. The first scenario shows the reduction in average lead times for average LIC mines if a price downturn shifts to a price upswing. The second scenario shows the reduction in lead times if control of corruption is improved to the levels of Chile and Namibia. The third scenario shows the reduction in lead times if quality of governance is improved to the levels of Chile and Namibia. "Price upswings" denotes reductions in lead times for the largest quartile of copper discoveries in LIC since 2000 as a result of switching from a commodity price downturn to an upswing. The same group of copper discoveries are used to measure the impact of corruption and quality of governance.