

Assignment 3.a – Essay (IT)

The country XYZ has 60% of world reserves of mineral AB. In XYZ, the AB deposits have been run by a government company, which is monopoly inside XYZ. The AB has widespread use in the many industries such as glass, metallurgy, fertilizer, detergents, ceramics etc. However, the AB is very elastic in all industries. That's why XYZ has no monopoly power on worldwide AB market. On the other hand, the AB has a potential to generate energy in future. Therefore, the AB is accepted as a strategic product. XYZ has no enough knowledge on energy generation potential from AB.

Imagine that you are the advisor to XYZ government for the policy making on how mineral AB will be produced. You are required to prepare a draft report about 300 words.

Note: There is no clear answer. Relevant concepts are Hotelling rule, deferring extraction, the Dutch disease and elasticity. The essay will be handwritten and uploaded on MyCourses. This is an individual work. Each student will upload her/his essay.

In order to make the most of the potential and gains of the AB mineral, the Hotelling rule, the deferring extraction, the Dutch disease and the price elasticity must be taken into consideration.

On the one hand, the Hotelling rule states that in a competitive market, the price of a depletable resource must increase at the same rate as the discount rate. Thus, by following this rule, it is more advantageous to defer the extraction of the AB mines in order for interest rates to rise and gain on the long term. This rule does not take into consideration the technological improvements and innovations in the industry, the discoveries of new reserves, the uncertainties of the size and grade of current reserves, the heterogeneity of the deposits, the increase in costs due to physical and economical exhaustion and finally the production capacity limitations. Deferring the exploitation of the AB minerals is very good in the short-term. Controlling mineral prices helps sustaining the monopoly of the XYZ country. But on the medium to long-term it can be a very risky move. The XYZ country can lose money if a substitution of the AB mineral is discovered or if that mineral becomes obsolete.

On the other hand, the Dutch disease and the elasticity the AB prices can cause harm to the XYZ country if the exploitation is not well handled. It can affect their currency and economy by deepening their dependency on AB exportation and increasing their importation of other goods. In addition, it can harm the manufacturing industry of the XYZ country and lead it into a crisis in other economic sectors.

In conclusion, it is in the interest of the XYZ country to mine and produce the AB mineral as soon as possible. But at the time, the XYZ country needs a long term economic plan; it needs to invest the revenues generated from the AB mineral in long term funds, in education, in the manufacturing sector and other wealth generating sectors.