Commodity Booms, Dutch Disease, and Real Business Cycles in a Small Open Economy: The Case of Coffee in Colombia

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This paper proposes a dynamic,stochastic, multisector growth model which integrates the real business cycle literature and booming sector and Dutch Disease economics to analyze fluctuations, resource allocation and relative price changes in small open (developing) economies subject to terms of trade shocks. The model is consistent whith aggregate and sectorial cyclical behavior of this class of economies, and rationalizes as an efficient outcome the symptoms of Dutch Disease (temporary deindustrialization and appreciation of the real exchange rate) which are sometimes judged to be suboptimal responses and as the rationale for government intervention in developing countries. It is also found that commodity price stabilization policies do not significantly affect the cyclical pattern of fluctuations and that their welfare benefits are second orden.