

Dutch disease

[Health & Medicine](#), [Disease](#)



(1. What is meant by the term?) Introduction Over 50 years ago on 1960, when a sprawl bed of liquid gas was discovered in North Sea, Netherland overjoyed exploiting the natural resource and became a net exporter of gas. The demand for Dutch guilder in order to purchasing gas, rose and made it extremely strong. It left a lot of currency to a level the manufacturing export was no longer competitive. Later on 1970, when oil price soured by 4 times; UK was tempted to invest in North Sea oil industry in Scotland.

Soon after exporting the oil, UK encountered with a serious recession following labor strike. Firm workers demanded for higher wage because their disposal income has decreased which stemmed from the fall in expensive commodity demand. UK has become a net export of oil and Pound got appreciated. The rest of the industry left the market and firms started cutting their cost of human resources. Since then the term of “ Dutch Disease” assign to those with heavy reliance on their supply of natural resources that downturn the non-resource aspect of economy.

The Export-oriented manufacturing system is divided to two parts; More competitive sector-normally energy sector- grow faster and further while the less competitive step back and the related employment fall substantially and in more serious crisis concludes to deindustrialization. Both mentioned event are correlated with exchange rate development. The term of “ Dutch disease” for the first time came in an article in The Economist -1977 that described the case as a natural resource curse.

The name of Dutch Disease generally associated with a natural resource discovery, but it can be seen in any trade or investment activity that results in a large inflow of foreign currency, including a rise in natural resource

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prices, foreign aid, and foreign direct investment. The inflow of American treasures into Spain in 16th and gold discoveries in Australia in the 1850s are other two example of Dutch Disease diagnosis. By 1978, this story repeated in Iran. The oil price jumped and other local roduct like hand crafts, carpets, agricultural product, minerals, precious stones, Zofran, Pistachio became expensive and was not affordable for the neighbors and other importers to import. Such small industries never sustained in the market and some of them wiped out. Iran became the importer of rice, wheat, carpets. That took many jobs and money out of economy. Russia is likely to be another victim of this disease. Nearly 40% of GDP, 60% of export revenue and 60% of government revenue depends on oil and gas production. General perception of Russian economics, like other resource-rich countries, expects the symptom of disease.

Russia as one of the main oil producer can easily impact on oil price by reducing or increasing the amount of production. In both situations, their intake of money from oil exportation is huge. It strengthens the Ruble and impact the export revenue as a whole. Besides pouring unmanaged wealth problem, the direct investors intend to invest in mines and oil/gas wells and rigs or take over the related companies (direct investment). Moreover the related industry attracts the indirect investors to stock market to buy their shares.

These all concludes to CAD appreciation which is not what a commercial sector of an economy try to reach at. Since we are on another side of history, revolution against energy consumption and climate change got more serious, the countries that are too dependent on natural resource are being

questioned more than before. Except for short-run effect of asymmetric growth on resource allocation and income distribution, we are better to think about long-run issue of not renewable resource depletion rate and future plan for rich-resource countries.

2. Detail and outline the channels that could cause such an effect)

Dutch Disease Mechanism

The underlying mechanism of the Dutch disease is that the real exchange rate of the resource-rich economy tends to appreciate strongly with the rise of the export revenues from the resource sector. In turn, the appreciation harms the economy's exports from the manufacturing sector leading, over time, to de-industrialization . Regarding the pattern of history, the resource-rich countries manifest a short term prosper while others fallen behind due to: .

1. Natural Resource discovery and exploitation
2. Increase in foreign currency
3. Foreign direct investment
4. Foreign aid
5. Natural resource price growth

While at the mid-term they would experience:

1. Resource price artificially inflate the currency
2. Run up in commodity price
3. Losing price competition in market
4. Become weak in manufacturing sector
5. Become a net import of manufactured goods
6. Losing export power in goods other than natural resources
7. Leading to uneven economy

This is the mechanism in which non-resource industries get hurt by resource industry which proudly increases the wealth and spread the benefit unevenly across the country that accounts for hidden economy turmoil, which make manufacturing jobs, move to lower cost countries.

Canada and Oil Sand Fever (3. Examine the evidence for Canada)

From 2002, the energy sector in oil sand of Alberta developed. The total rise of world oil price covered all

extra cost of oil sand refinery process and made it profitable to that level which triggered exploration, expansion, extraction and export of oil.

Obviously the nominal GDP per capita jumped and the Canadian exchange rate appreciated and the manufacturing sector has contracted. While the rise of the energy and commodity prices brings obvious benefits for Canada as a whole, it has raised also a lot of concerns of policy makers and economists. Tom Mulcair, the NDP leader, who is being accused of dividing the country against each other, named the oil sand of Canada the dirty oil. He said that the booming of oil industry in Saskatchewan province would hollow out other provinces' economy.

He believes the oil exportation drive up the value of dollar and hurt manufacturing sector. The studies show that the appreciation of Canadian dollars relative to USD is driven by three factors. One of them is the strength of the CAD due to export oil, secondly the weakness of the USD, increase the appreciation of CAD, and the last factor is the booming of world energy price. Between 2002 to mid-2008 the price of oil and the other commodities got back to very low levels, however the manufacturing sector remained at the same weak status.

The Dutch phenomenon becomes a disease if the manufacturing sector does not come back when the resource boom is over. (4. Arguments for and against the preposition) Investigating the proposition that the country has experienced a period of Dutch disease, two conditions may need to be fulfilled. First, see if currency appreciation has driven up by the export oriented commodity prices. Second, see to what extend unemployment has been affected in the manufacturing sector. According to Krugman (1987), it <https://assignbuster.com/dutch-disease/>

becomes a disease when the manufacturing sector does not come back after the resource boom.

There are some contra verse arguments which claim that natural resource industries create jobs. Strong currency brings significant growth. While the food and energy security is so important in today's world, there is no reason to blame these sectors for bad economy. Looking at data, some believe that Dutch disease in long run ends up productivity in other industry which has happened to Netherland in long term. (5. Government role to reduce the incident or mitigate the effect- foreign exchange intervention) "

The gratification of wealth is not found in mere possession or in lavish expenditure, but in its wise application. - Miguel de Cervantes Saavedra

Under transparently and wisely management, if government can diversify the manufacturing and export sectors to reduce dependency on the booming sector and make them less vulnerable to external shocks, such as a sudden drop in commodity prices and at the same time avoid dumping all export revenue in the economy and devote fund of energy revenue to enforce other part of the industry through privatization and restructuring, the economy would be more resilience and integrated.

In countries with temporary resource discovery, policymakers may want to protect the non-trade sectors through foreign exchange intervention that is, building up foreign exchange reserve through the sale of domestic currency to keep the foreign exchange value of the domestic currency lower to insulate the economy in condition the extra wealth spend wisely and to lead to inflation.

Nobody expect government to call for a slowing down of resource development, but it is expected that policymakers help to boost the innovation, investment in human resource and spend more on research and development which leads to higher productivity of skilled worker via retraining which should benefit the vulnerable sector. Developing the new energy infrastructural -pipe and rigs- intelligently and sustainably help peaking natural gas prices not being blamed for driving up inflation and driving down exports of manufacturing goods. In Russian, a few think that the national population must meets the domestic supply.

They claim that they are not that much depends on export revenue. Moreover they firmly believe that their non-oil industry is not that much big to get hurt from global competition and they would continue to develop the oil sector which is more competitive and they are good at. In Chad, after oil discovery on 2004, the Chadian government invested the income on developing crop production and feeding poor people at the same time. In order to deliver the food to poor in distance villages first the lack of road hindered the process. So the next object was to improve transportation infrastructural.

That was the example of successful policies for avoiding Dutch disease. Using the country's huge income of oil and gas for public and rural household welfare and investing particularly in, for example, development of road and irrigation infrastructure and improving water access would adverse the affection of Dutch disease. " If revenue can create a serious opportunity for development andpovertyreduction, it certainly is a good opportunity for corruption as well, feeding political claims and increasing the risk of conflict"

(page 47) Exchange rate and Spending effect (6. fixed exchange rate) The inflow of foreign exchange by importers initially raises the country's income. There are two policies how to spend the money. If the foreign currency is traded with foreign commodity and spend on import, the domestically produced goods are remained unharmed. But suppose it is converted to local currency, this time the local productions get affected. If the central bank decided for a fixed nominal exchange rate, after conversion the currency, the money supply increases, the local demand increase and local production price rise which leads to higher real exchange rate.

If the exchange rate is flexible, the value of the domestic currency increases due to the increased supply of foreign currency, which again leads to higher real exchange rate, in this case through a rise in the nominal exchange rate rather than in domestic prices. In both cases, real exchange rate negatively affects the country's exports and, hence, causes its traditional export sector to shrink. This entire process is called the " spending effect. " •Corden, W. M. and J. P. Neary. 1982. Booming Sector and De-Industrialisation in a Small Open Economy.

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