

Dutch Disease in Economy Country and its Effect on the Price of Products Ready for Selling

¹Mansour Alilou, ²Roya Ahakchi and ³Magsoud Alilou

¹Young Researchers Club, Salmas Branch, Islamic Azad University, Salmas, Iran

²Department of Economic, Salmas Branch, Islamic Azad University, Salmas, Iran

³Department of Accounting, Salmas Branch, Islamic Azad University, Salmas, Iran

Abstract: Regarding the need of society to identify the economical diseases of developing countries, we observe symptom of Dutch disease in the economic subdivisions of these countries and by studying and comparing economy of developing countries with those countries which have experiences this economic disease we can get some results than can be serious alarm to economy of those countries with one product. Dutch disease can increase demand in society and finally increase the imported consuming products resulted in decreasing of internal products demand and closing of manufacturing units. This paper studies the symptom of Dutch disease and its effect on the prices of products and provides solution to cope with this economic disease.

Key words: Dutch Disease • Financial policies • Holland economy • Petroleum income • Government

INTRODUCTION

Some remarkable natural gas resources were discovered in 1959 in Holland and this discovery was developed fast in early 1960 and brought about a lot of cash revenue. Improvement of exports and of payment caused a new welfare. Instead, Holland economy was damaged by raising inflation, products export decreasing, lower rate of income and unemployment increasing. Because that phenomena caused workforce and production facilities to move from industrial part to other parts as office services and construction companies. Due to this happening in 1960s and early 1970s, about 10-15 years, the important industries of Holland were nearly disappeared or they lost their international competing ability. Holland government conducted different policies to cope with this Disease. So since 1977, this Disease has been called Dutch disease.

The Procedure of Dutch Disease: This disease occurs when income of a country is suddenly increased because of some temporary factors and economy responsible of government spends this money into the society with this idea that this income is permanent. But by increasing of income, demand is also increased. If this demand increase is done suddenly and presentation can't answer to demand and the balance is ruined, so the prices increase.

In a natural procedure the prices rise up to a definite level and production increases after a delay and finally a few some time presentation and demand get their previous balance [1]. But Dutch disease happens when the government as a responsible of massive economy tries to keep the prices without increasing of production. It adheres to import cheap products to control the prices whereas the internal industries have to produce expensive products and sell them cheaply. This policy can't control inflation, but spreads it to other parts of economy. For example, by importing products as rice, tea, girder and..., prices can be kept steadily but some goods as field and house aren't capable to be imported and the increase of prices of these goods can't be controlled. As a result the prices of these goods increase on the other hand new investment in those economical parts whose prices can't be controlled by importing them aren't carried out and stocks are led to some goods as field and house, which results in untrue demand of these goods and their prices increase unnaturally. When the increase of income finishes and government doesn't have more money that imports cheap products the prices of those parts which were lower due to imported products increase quickly and because the internal industries are inactive due to the previous policies so they can't satisfy the new demands and it makes economy inefficient [2].



Table 1: Stages of Dutch disease in production process

The Disease Model of Holland Economy Can Be Analyzed in There Parts: Tradable part of natural resources, tradable part of industry and untradeable part. Abundance of natural resources is in company with increasing demand for untradeable goods and strengthening the real rate of money and as a result fewer shares of workforce resource and stock are allocated to industry part. So the comparable focus productions on natural resources instead of industry and workforce and stock which should be used in industry is moved to production unit of untradeable goods. When economy experiences an increase of natural resources exporting (because of improvement of commercial exchanging or discovery of new resources) the trade able part industry is weakened due to the increase of real value of money and untradeable internal goods as (field and house) develops [3]. Weakening of trade able part in this model is called illness. In other words, assuming that improvement of industry production has outside effects, weakening industry by abundance of natural resources result in inefficiency and much decrease of economic growth. In the studies conducted in this field, about the negative effects of natural resources on growth, it is concluded that in economic based on natural resources, there is a tendency to increase the internal prices that results in lack of growth based on exporting. Table 1 is indicator of procedure steps of Dutch disease in production process:

Is Dutch Disease Just Made Because of Gas and Petroleum Exporting?: This disease is usually in company with discovery natural resources, but it can be caused by each improvement in input flow of money and isn't necessary to be resulted by exporting a lot of goods as gas or petroleum, but each sudden income can have this effect. For example the input flow of external

stock in the from of a gold and silver from America continent may have resulted in industry inactivity in 16th century in Spain and the investment flow into US. May have contributed to less competing of Spanish industry in 1980s the experience of Suitland in 1970s can be an example of this illness [4]. This illness may be a result of sudden development of technology in one part of industry. For example in 1070s and early of VBs the quick development of automobile manufacturing industries to Japan caused that most of traditional industries as cloth and silk to be weakened. In Australia in 1966-75, this phenomena occurred due to doubling of coal exporting and also in England in 1975 because of petroleum discovery in the North Sea. In the late of 1970s the increase of coffee price caused improvement of coffee exporting countries as Colombia. This resulted in damages in traditional exporting part, in generally the expenses and resources were moved into Non-tradable goods.

MATERIALS AND METHODS

England Experience of Dutch Disease: Regarding the effects of petroleum discovery in North Sea on English economy, two economists called Key and Forsyth presented a reporting based mostly on empirical evidences which establish the basis of discussions related to anti-industrial phenomena in Britain. It was reported that when the increase of petroleum results in remarkable optimizing of one part in internal payments rate, there mustn't be created a mutual slump in another part of payments rate to balance the payments rate in long-term. So, because factories have wide shares in proportion to whole of economy in trade able goods part in England, the concerned effects focus on factories which result in decrease of these industries shares in

economy that is the same phenomena of anti-industry. As what was experienced in Holland also here the increase of real value of money is a mechanism that creates the structural change. And dependent on increase of real value of money that as far much it was made by increase of formal value of money, less direct profit is allocated to country from the increase of petroleum. Suppose that income tension in all parts of economy could be the same, these two writers concluded in their evaluations that each 5/5 increase of productions in English economy resulted by to million pounds increase in added value of petroleum part, leads to 9/8 decrease of industrial products in this country. Meanwhile the rate of activities in distribution part and services increases just to a 4/1 level. Instead of that, increase of petroleum causes untradeable goods part to be expanded. Also in this study, two untradeable parts, i.e. housing and network of governmental offices had an increase of 8 percent. The said writers stating that each one percent share decrease of factories products in whole products of country removes exactly 70000 job opportunities suggested that enough amounts of overflow income should be invested by which they can be changed to permanent forming factors of national income. Also based upon the internal investments that how much they increase demand in housing part (untradeable part). External investments (directly in financial markets) seems more proper [5-6]. Also as it is predicted that the increase of real price of petroleum will be upper that read profit of external investment, the storing of petroleum will be a more suitable investment, the storing of petroleum will be a more suitable way.

The History of Dutch Disease in Iran: The first evidences of entering Dutch disease to economy of Iran dates back to 1975. In this year the general budget of country was doubled due to the increase of petroleum price up to the four times and the current government presenting the slogan of free educating and decrease of basic goods increased the publics exportations. But due to the growth of importing and decrease of internal production level simultaneously with 14 percent decline of petroleum income between 1977 to 1979 a period of economic inactivity started and because of cash increase the inflation rate of country in 1979 raised to 35 percent. And government made commitment to spend huge public expenses and decrease of petroleum income resulted by decrease of its price caused the governmental practical ability to satisfy the public needs to be declined. Since the

Islamic revolution in society because the increase of current expanses and the shortage of budget that is faces by government each year cause government to use. Anyway, being dependent on petroleum income isn't a solution for economy of country. Because the undulation of petroleum income is a threat for economic stability of Iran and two previous decades has shown that how decrease of petroleum income can be threatening among which Dutch disease can be an example. Actually by decreasing the price of petroleum the will be zero and there will be impossible to balance the undulation of petroleum income. Government shouldn't consider its future income based on the changing prices of global markets and should evaluate some errors in its future predictions. When petroleum income of exporting countries faces with positive shock, complete investing of it in a year will have inverse effects and results in activating economic defected mechanism in the frame of Dutch disease [7].

The Effect of Dutch Disease on the Cost of Goods Available for Sale: Manufacturing companies in a society are considered as the main economic gears of that society and they are the primary goals affected by Dutch disease. In manufacturing companies the price of a product on sale is computed based on the used ingredients, taxes, fixed and variant exposes [8]. When a society gets this Dutch disease and injects money directly into budget, so cash increase among people and causes increase of demand for products and because in countries with one product traditional ways are used in producing, so internal products can't answer the society about the quality and quantity of product, so the government begins to import some products as (clothes, furniture,...) and because imported products from industrial countries have better quality and lower prices than the internal produced ones, demand for buying imported products increases which results in presenting the products lower than their real prices by the internal production companies. For example: a company sells its products about 50 dollars and it gains 79 dollars from selling each product, if the importing of the product is conducted by 40 dollars, the internal producer must increase its product price to 39 dollars, this causes the company to lose 1 dollar for each selling, so it can ever continue its procedure and results in unemployment rate increase.

Treatment of Dutch Disease: Figure 1 show the treatment process of Dutch disease in economic divisions.

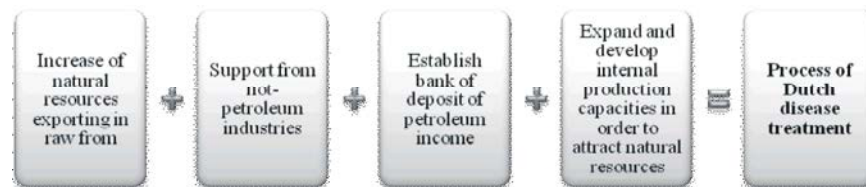


Fig. 1: Stages treatment of Dutch disease in country

Decrease of Natural Resources Exporting in Raw Form:

Regarding the negative relation of fuel exporting share from whole of exporting, with the economy of studied countries, it is suggested that high volume of raw petroleum exporting to be reviewed and by using the experience of successful countries in this field, natural resources exporting in raw form to be minimized.

Supporting Non-Petroleum Sections: Because the procedure of economic adjustment is acted inversely when the economic status is declined, development of non-petroleum and untradeable section face with problems, so entering into exporting markets will be difficult, too, because other countries have dominated the markets. So, in this situation, adopting economic policies in order to protect from production section against the harmful effect will be reasonable.

Establishing a Bank of Deposit for Petroleum Income:

By establishing this bank of deposit, obtained income by petroleum exporting is invested and changed to another forms of producer capital. Also by gradual and stable absorbing of these incomes Dutch disease and its negative effects are prevented in economy. Studying the criteria of Norway bank of deposit can present more positive point to opposite the negative effects of petroleum income on these economies [9].

RESULTS AND DISCUSSION

Developing and expanding of internal production volume to attract natural resources: Due to this point that one of the most important factors in maintaining the policy of raw petroleum exporting is the lack of ability to attract these resources in internal production, so developing and expanding of internal production volume to attract natural resources and change them into products in a way that added value and resulted income lead to employment and welfare is suggested.

Repelling Policy Against Dutch Disease: Figure 3 steps of government policy in order to repel against the Dutch disease shows.

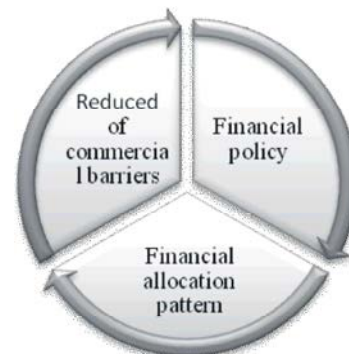


Fig. 3: Steps of government policy in order to repel against the Dutch disease

Financial Policies: A government may adopt policies to adjust extra money of payment rate. Adjustment means that income resulted by affecting on relative prices should be absorbed in internal economy. UN adjustment policy neutralizes financial effects of payments rate through buying external stocks. These purchasing are as stock outgoing that removes payments. In choosing the type of adjustment, government has two potential tools [10-11].

Accounts Allocation Pattern: The government can have a key role in the future of industry by providing accounts to industries or by depriving them. The general volume of formal accounts for trade able products sections is probably allocated to subdivisions in big sale in industry and agriculture. Although investment is possible in short term is considered as a correct response. But it may not be correct in long term. So the strong undulation identity of petroleum income dependent on industrialization process and based on importing may cause some problems for economic management of country [12].

Reduced of Commercial Barriers: It means decrease of commercial barriers as shares of importing. Lower prices of imported products must have the same effect of “expense change” resulted by strengthening the real value of many, especially if the exporting barriers are located at top levels. Those direct interfering are the last shelter of government and are applied when other policies are ineffective [12-13].

CONCLUSIONS AND SUGGESTIONS

By glancing on Dutch disease and the experience of different countries this reality is obtained that the expansion of subdivisions and trade able face with difficulties when infrastructures have been ruined. Entering the exporting markets will be difficult, too: because other countries have dominated the markets. So, adopting economic policies in order to protect production section against harmful effect will be rescannable. Actually the treatment of Dutch disease depends on prevention or reversing increase of real value of money, so the government needs to persist against the developing demands and to invest new income in order to have enough time to plan intellectually and identify high income. As a result, the only way to be away than this disease, is resistance against it and this is inst done by correct policy in developing of production sections and financial support from private section.

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