Forbes

The Euro's Dutch Disease

By: Bob McTeer **July 1, 2012**

I've been aware of the phenomenon called the "Dutch disease" for a long time, but that label is fairly new to me. According to Wikipedia, the term was coined in 1977 by *The Economist* "to describe the decline of the manufacturing sector in The Netherlands after the discovery of a large natural gas field in 1959." Dutch exports of gas elevated their exchange rate to levels that made their manufactured goods less competitive.

Of course, the concept would apply broadly to any sectors sharing the same currency. Many other U.S. products would possibly become competitive in export markets were it not for Boeing's significant export of airplanes. More broadly, in the United States, for example, the dollar made artificially expensive by capital inflows related in part to its reserve currency status has prevented the exchange rate adjustment needed to balance our trade in goods and services. To stretch a bit, one might even say that the success of U.S. finance has made the real, or goods, sectors less competitive internationally.

The headline of a June 26 *WSJ* article, without using the term Dutch disease, nevertheless, suggested how the phenomenon is affecting Japan:
"Strong Yen Dings Exports By Japan's Top Auto Makers." While the Yen has appreciated substantially against both the dollar and the euro in recent years, Toyota was reported, ironically, to be considering exporting to the U.S. from an underutilized plant in France.

The Dutch disease becomes even more prevalent for the 17 nations sharing the Euro. The common currency magnifies the butterfly effect of positive or negative shocks within the Euro zone. At a broad level, the Dutch disease's latest manifestation is the decline in the Euro caused by the debt crisis in several, but not all, Euro member countries. The decline in the external value of the Euro will be beneficial to the troubled countries causing it, but it leaves Germany, in particular, in an awkward position. German exporters probably don't need the boost to their competitiveness, and German consumers certainly don't need the reduction in their purchasing power.

When the music stops, countries living beyond their means must lower their standard of living one way or another. A declining exchange rate is a less painful way to reduce real incomes than is a decline in nominal incomes in the domestic currency. Unfortunately, devaluation only for those needing it is not now an option in the Euro zone.