Dutch disease is not infecting Canada

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The political landscape is littered with talk of Canada having the Dutch disease.

To clarify, it is not something that is contracted from a weekend in Amsterdam. And yes, Canada does not have it.

The Dutch disease is a condition where a country's currency rises from an increase in revenues from natural resources. The high currency then undermines the manufacturing sector by making these exports more expensive.

As the argument is playing out in Canada, oil is the cause of the disease and Ontario is the one who suffers.

Yet in 2011 export growth for passenger cars was two times that of oil, while gold was three times that of oil. In fact, oil export growth was middle of the pack, even when compared to other commodities.

And if oil, for which Canada is the world's eighth largest exporter, is a driver of Dutch disease, shouldn't the severe drop in the price of natural gas – a commodity for which Canada is the third largest exporter in the world – also be taken into account? For example, in 2011 Alberta reported that its natural gas royalties dropped to about just 3.6% ($1.4-billion), down from about 15% of provincial revenues ($5.8-billion) in 2009.

It is difficult to show what is causing a decrease in the lagging sector. A case in point is the Netherlands. Though this effect is named after the Netherlands, economists have argued that the decline in the Dutch manufacturing industry was actually caused by unsustainable spending on social services, and not an increase in revenues from natural gas discoveries.

The Canadian dollar is strong for a variety of reasons, of which oil resources is one. The country has a strong fiscal position, its banks are well capitalized, credit is available and the real estate sector has not gone off the rails. These days, there are a shortage of healthy, growing economies in which to invest and prosper. Canada is one, creating a strong dollar.

Dutch disease proponents tend to focus their attention solely on imbalances caused by goods exports. However, advanced economies are increasingly weighted towards trade in services – which comprise three quarters of Canada’s economic activity – and investment, which allows Canadian companies to establish a presence in foreign markets and service the customer base from there.

For example, Canadian banks have expanded dramatically in the U.S. in recent years and have added more than 2,800 workers in the most recent quarter, while staffing at the ten largest U.S. banks declined by 8,577 in the same period. For every worker hired at one of Canada’s eight main lenders in the first fiscal quarter, three were let go by their U.S. counterparts, according to Bloomberg.

Goods trade is also poorly measured, further misinforming the Dutch disease debate. Thirty years ago, products used to be assembled in one country, using inputs from that same country. Measuring trade was easy. 2012 is very different. Manufacturing is driven by global supply chains, and most imports should be stamped “made globally”, not “made in Canada”, or similar.

In international trade the total commercial value of an import is assigned to a single country of origin, as the good reaches customs. But today the concept of country of origin is often obsolete. What we call “made in China” is indeed assembled in China, but its commercial value comes from those numerous countries that precede its assembly.

For example, Apple’s iPhone is assembled in China, then exported to the U.S. and elsewhere. Yet the components come from numerous countries. According to a study by the Asian Development Bank Institute, the phone contributed $1.9B to the U.S. trade deficit with China, using the traditional country of origin concept. But if China’s iPhone exports to the U.S. were measured in value added – meaning the value added by China to the components – those exports would come to only $73.5M.

It isn’t just phones. Automobiles, aircraft, processed foods and even clothing are increasingly made in many countries. No car or commercial jet could now be built with inputs from just one country.

If we are to debate something as important as an alleged disease caused by trade imbalances, we should do it on the basis of numbers that reflect reality. At present, a distorted picture is being used to manufacture a politically attractive wedge issue.