Carney rejects Dutch Disease diagnosis for Canada

By Les Whittington
September 7, 2012 – *The Toronto Star*

Bank of Canada Governor Mark Carney waded into the heated political controversy over western Canada's oil boom, dismissing the argument that higher commodity prices are distorting the national economy.

"Bank of Canada research shows that high commodity prices, regardless of the cause, are good for Canada," Carney said in a speech in Calgary Friday.

The global commodities boom drives enormous benefits for Canada, including higher incomes and greater economic security, he added.

"The strength of Canada's resource sector is a reflection of success, not a harbinger of failure."

He was addressing the issue of so-called Dutch Disease, which has been the source of bitter arguments in political circles. The issue blew up last spring when NDP Leader Tom Mulcair said this phenomenon was responsible for the loss of some of 500,000 manufacturing jobs that have disappeared in Canada in recent years.

Dutch Disease, which originally referred to the impact of natural gas development in the Netherlands, is said to take place when a country's natural resource riches temporarily drive up the value of its currency on exchange markets. This makes the country's exports more expensive to foreign buyers, thus undermining the competitiveness of the country's manufacturing industries and causing long-term damage to the economy.

Mulcair says this is happening in Canada and has called for measures to develop the oil sands in a more measured and sustainable way. His stance touched off a bitter controversy, with Prime Minister Stephen Harper's government accusing the NDP leader of being anti-growth and of irresponsibly pitting westerners against other Canadians.

Carney said some people regard Canada's wealth of natural resources as a curse along the lines of Dutch Disease. "While the tidiness of the argument is appealing and making commodities the scapegoat is tempting, the diagnosis is overly simplistic and, in the end, wrong," the central bank governor said.

"Canada's economy is much more diverse and much better integrated than the Dutch Disease caricature. Numerous factors influence our currency and, most fundamentally, higher commodity prices are unambiguously good for Canada."

He said the diagnosis of Dutch Disease in Canada is wrong because it assumes commodity prices will subside. Carney said this is unlikely at a time when emerging economies are rapidly urbanizing.

Also, the decline of Canada's manufacturing sector is part of a broad trend across the advanced industrial world, reflecting globalization and technological change. He added that only about half of the rise of the Canadian dollar on exchange markets in the past decade can be attributed to higher natural resource prices.

Other causes of a rising loonie are the depreciation of the U.S. dollar and the fact that Canada is seen as "a rare safe haven" by investors.

He concluded that following the Dutch Disease diagnosis would require Canada to try to lower the value of the loonie. To do so, Canada would have to "shut down the oil sands, abandon our resource wealth, have high and variable inflation, run large fiscal deficits and diminish our financial sector," Carney said.

"Such actions would surely weaken the Canadian dollar, but they would also weaken Canada."

"The symptoms we are seeing (in the Canadian economy) are not those of Dutch Disease but rather of structural changes in the global economy to which Canada must adjust," he went on.

Carney, who angered big business last month by saying corporations are sitting on billions of dollars in "dead money" that should be invested to improve expand production and help the economy, didn't shy away from that topic Friday.

He said it's obvious business is reluctant to invest at a time of global economic uncertainty but suggested Canadian companies are being overly cautious.

"With the strongest (corporate) balance sheets on record and benefiting from one of the most resilient financial systems in the world, the need for Canadian firms to build additional precautionary cash balances appears limited."

Instead, they should control their own destiny "by building on our strengths in the new global environment," Carney said. The Bank of Canada expects "sustained business investment" by Canadian companies, he noted.