



The Dutch Disease: Lessons for Mongolia



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The curse and the disease

- Mongolia is at the brink of a mineral-based economic expansion
- Paradoxically, resource-rich countries, like Mongolia, often fall prey to the natural resource “curse”
- They grow slower than resource-poor countries (on average)
 - Suffer from weak political and economic institutions
 - “Point-source” resources such as oil and minerals lead to poor institutions because they create an often unhealthy political contest
 - Dutch Disease (a macroeconomic infliction):
 - appreciating currency, high public spending, debt, inflation
 - Makes non-mineral sector uncompetitive
 - In the Netherlands: “stagflation”: low economic growth, high unemployment, plus inflation

No curse, but risk of disease

- “Resource-poor” economies grow through the development of a competitive market economy:
 - Depend on being able to create the type of institutions which allow for competitive markets to thrive such as:
 - Secure property rights and the rule of law
 - Other institutions, infrastructure, human capital, etc.
- To be cursed, the timing of the resource discovery matters
 - When good institutions are already in place, the rents for the resources are, **on average**, not captured by exploitative elites, but used to promote national welfare
 - Mongolia fortunately falls into this category with democracy in place
 - but with macroeconomic challenges similar to what happened in the Netherlands..



What happened in the Netherlands?

Natural gas caused the disease

GDP, industrial production, inflation, unit labour costs and the nominal exchange rate in the Netherlands

% yoy

Index 1971=100

Average annual growth rate, by sector in the Netherlands

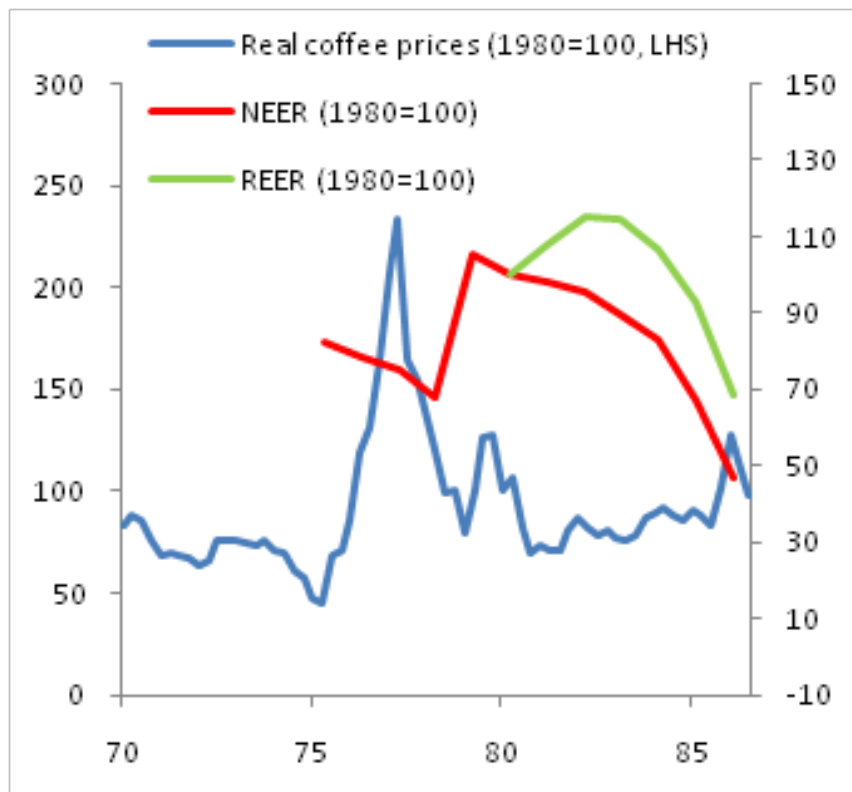
Average annual growth rate, %

And in Colombia...coffee

Coffee prices and exchange rates in Colombia

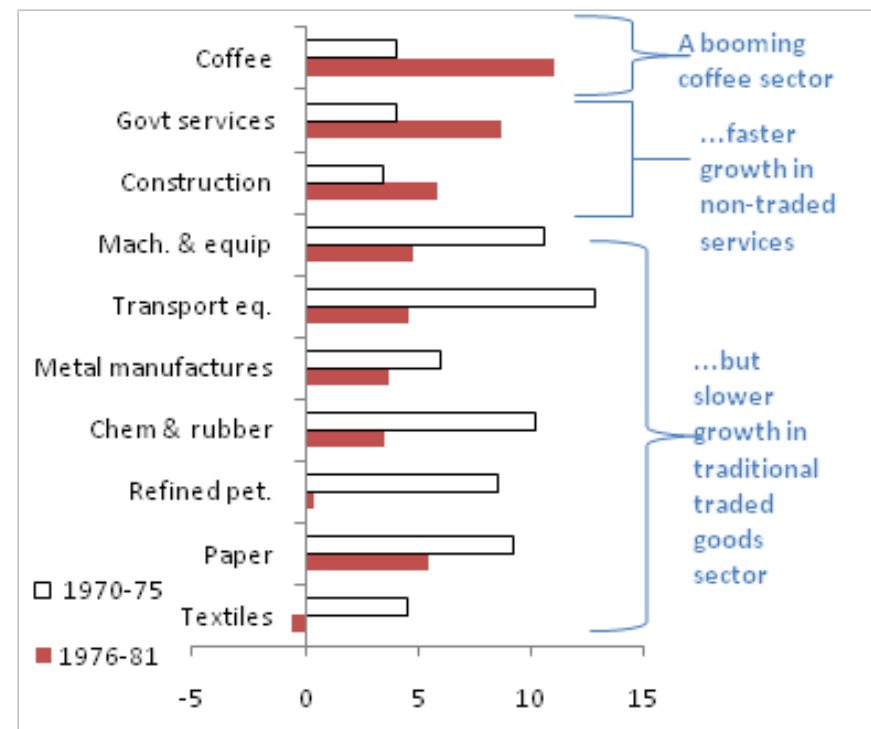
Coffee prices

Nominal and real effective
exch. Rates (+: app)



Sector growth in Colombia

Real, average annual growth rate, %

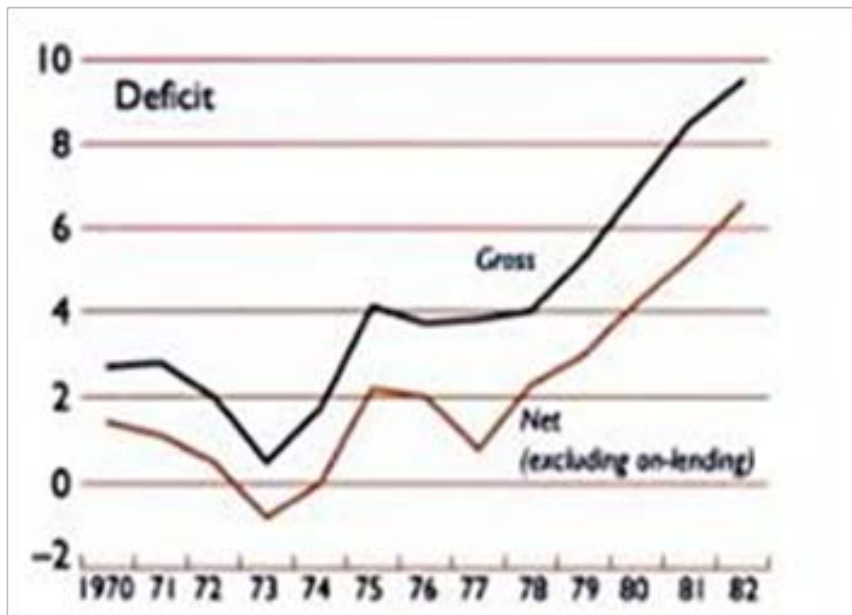


The Dutch “Welfare State”

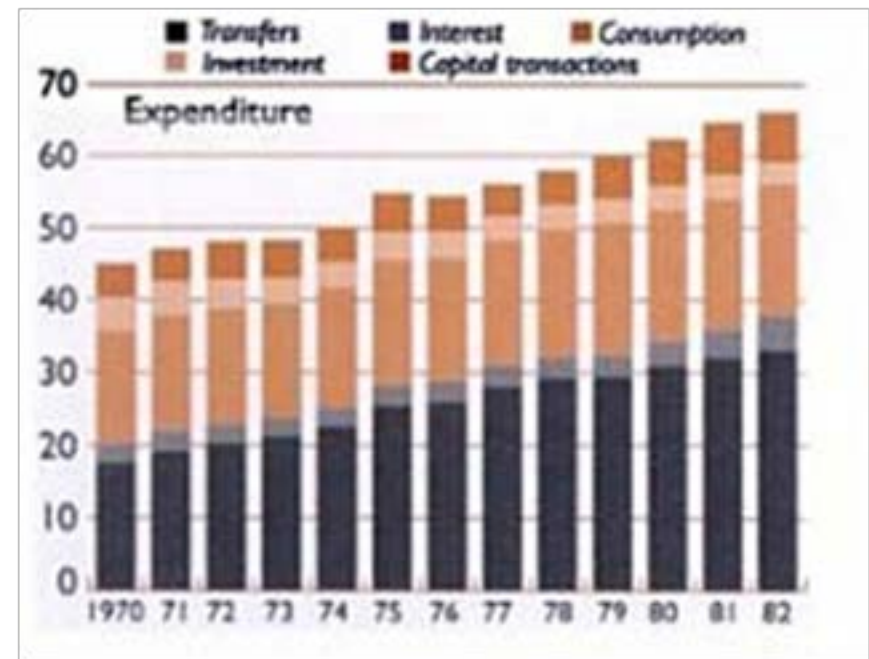
Rising budget deficits in the Netherlands

mainly due to sharp increase in expenditures on social transfers

% of GDP



% of GDP



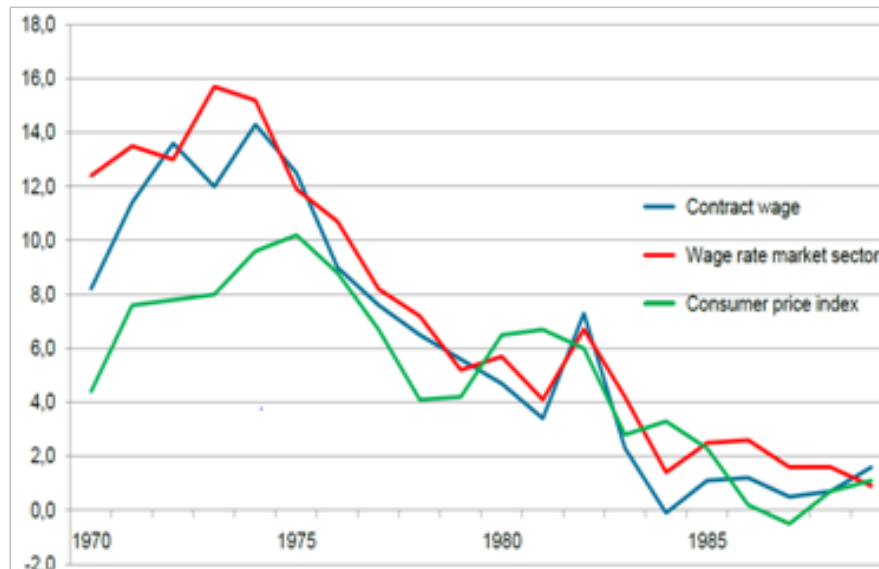
Curing the disease

Labor agreed to reign in wage increases

Government agreed to restrain spending

% of GDP

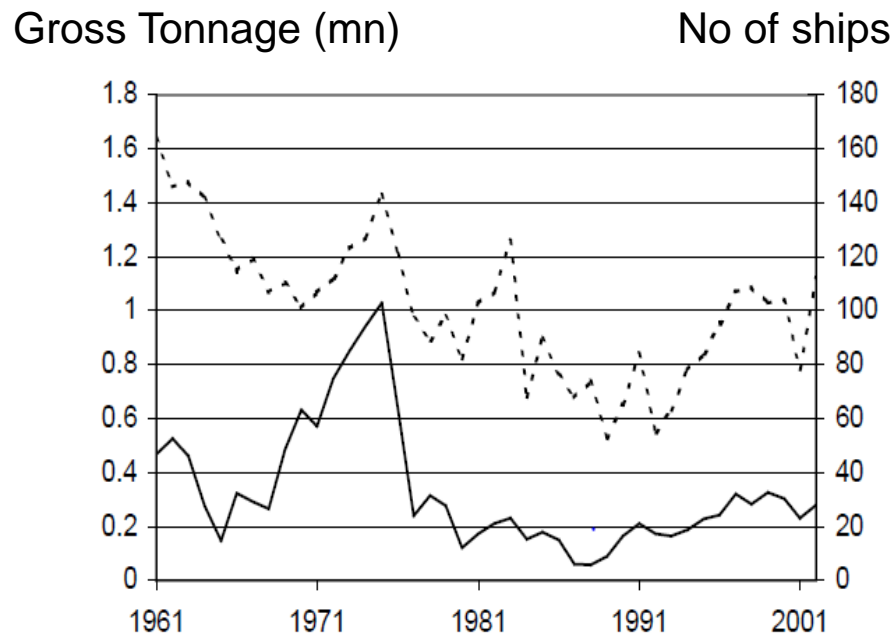
% of GDP



□

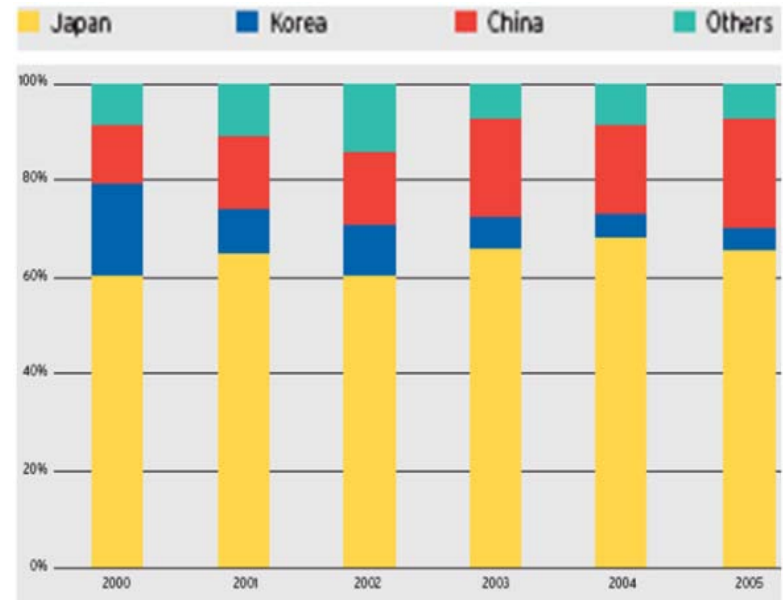
But it was painful...

Impact of Dutch Disease on shipbuilding



Global market shares of bulk carrier production

% of total deadweight tonnage

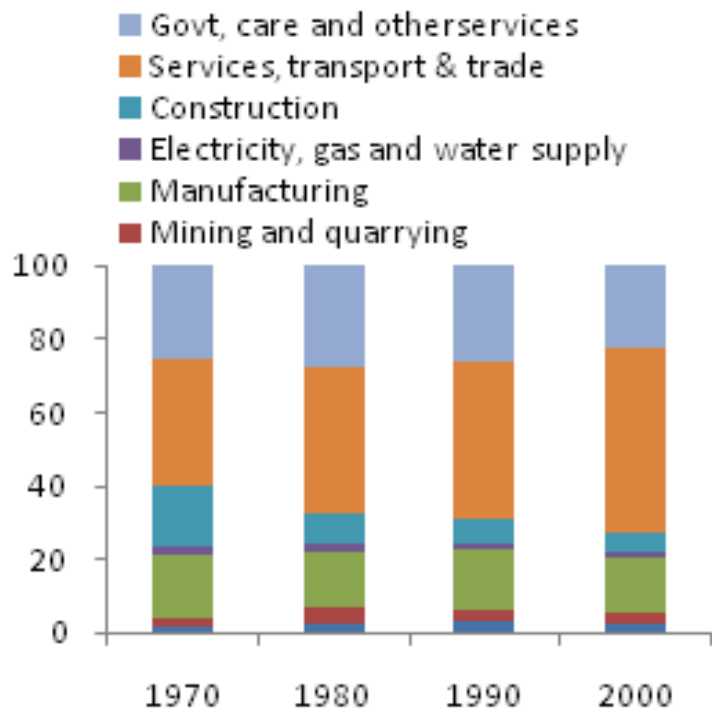


Diversify

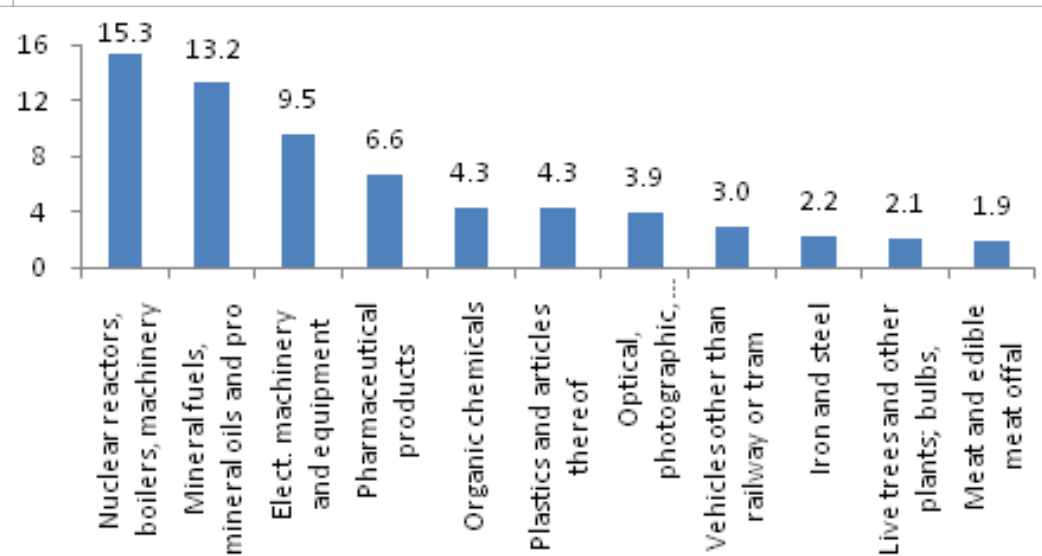
Structure of the Dutch economy

Top 15 Dutch Exports, 2009

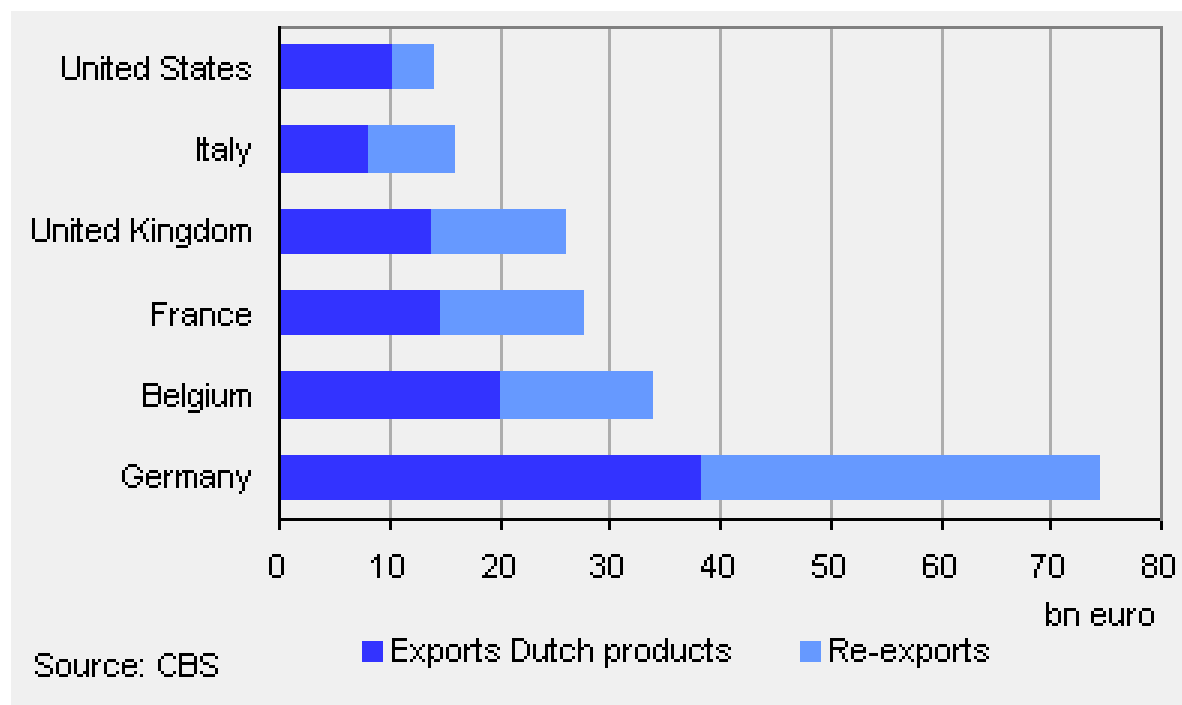
% of GDP (2000 prices)



% of total



Exports mainly to Germany



Central Planning Bureau

- Has never done any central planning... 😊
- Does independent policy analysis at the request of government, parliament, labor unions, business associations, or on its own initiative
- Director is appointed by the Minister of Economic Affairs
- But it has its own governance structure
 - Oversight committee (economic stakeholders)
 - International “quality control” (every 5 years)
- The first director: Jan Tinbergen
 - winner of the Nobel Prize in economics in 1969
- Keeps political promises in check



Avoid the Dutch Disease, proceed straight to the Polder Model?

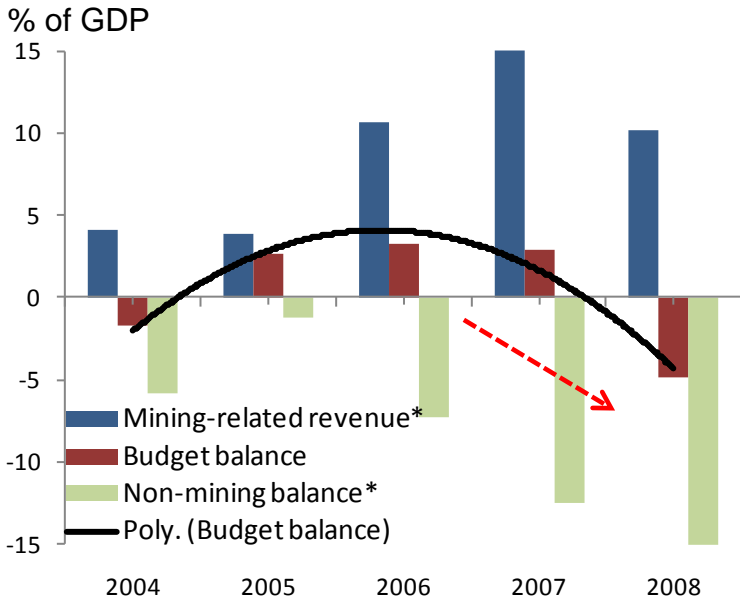
- How did a democracy with good institutions deal with the sudden discovery of mineral wealth and its disease?
 - a strongly appreciating currency made the non-mineral sector uncompetitive
 - inflationary and unproductive government spending on wages and social transfers
- The responsible parties (government, labor and business) negotiated agreement among themselves to cure the disease
- The cure was centered on conservative fiscal policies, including low public debt, and wage restraint vis-à-vis Germany
- Became known as the Polder Model
 - Later, it became an inspiration for Germany... 😊
 - And a framework which held up very well during the 2008 global financial crisis

Fiscal Stability Law of 2010

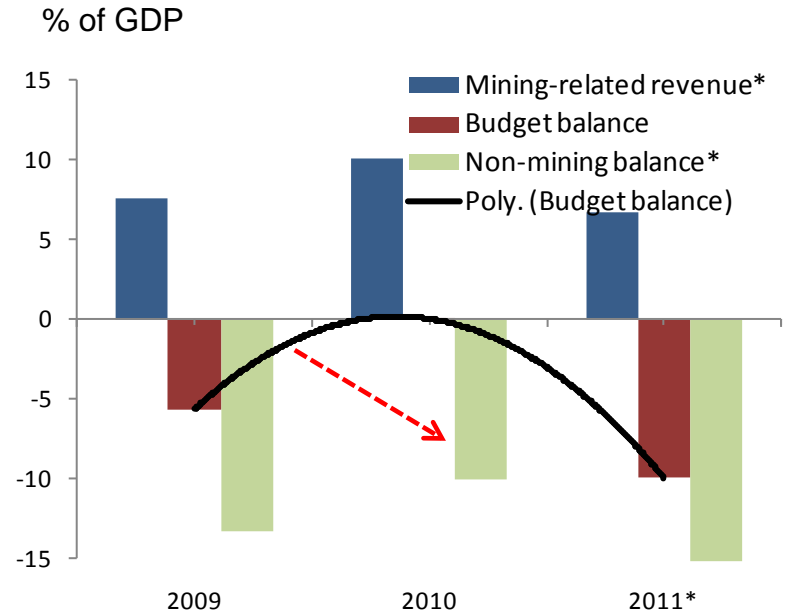
prevents Dutch Disease

1. The structural balance rule helps protect budget expenditures from mineral price fluctuations
 - A ceiling on the structural fiscal deficit amounting to 2% of GDP
 - Excess, temporary revenues are saved in reserves (stabilization fund)
2. The expenditure growth rule limits the growth of expenditures to the non-mineral GDP growth rate
 - Important not only to prevent “overheating” of the economy but also to maintain quality of public expenditure
3. Debt rule avoids over-borrowing at the expense of future generations (limit set at 40 percent of GDP)
4. Annual budget and budget amendments must abide by Medium –Term Fiscal Framework (which in turn must follow the fiscal rules)
5. ...but only kicks in fully in 2013...

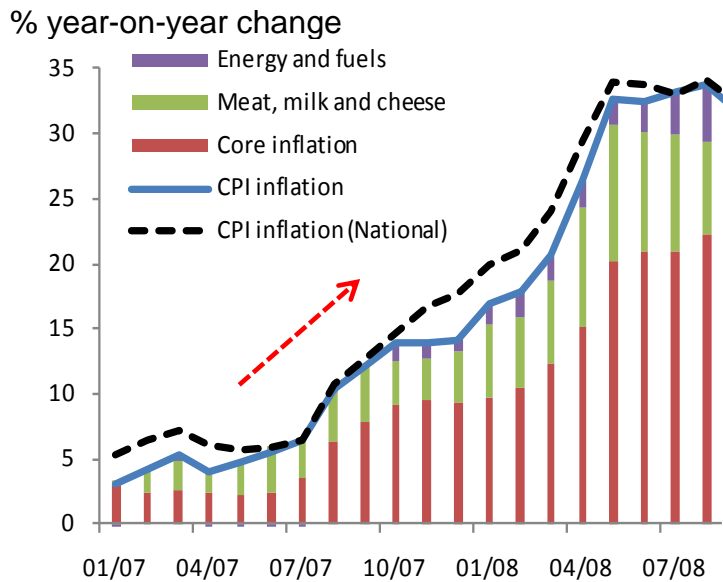
Budget balance, 2004-2008



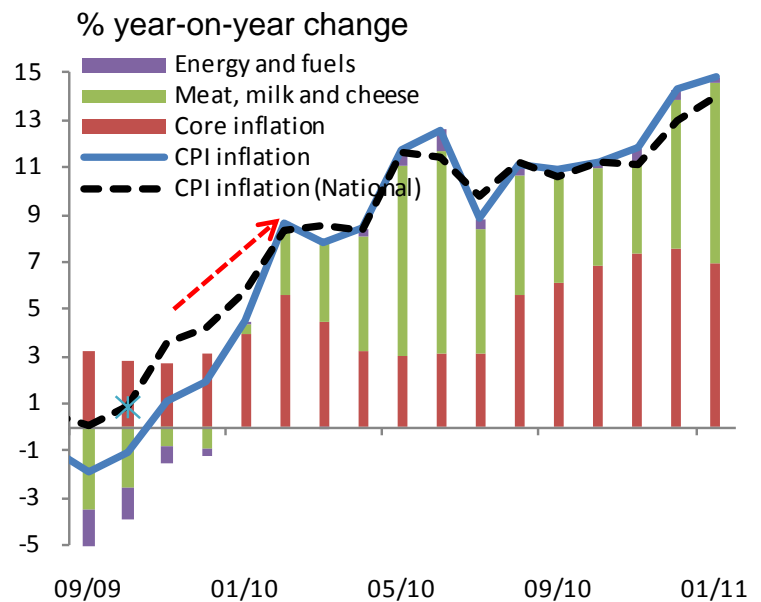
Budget balance 2009-2011



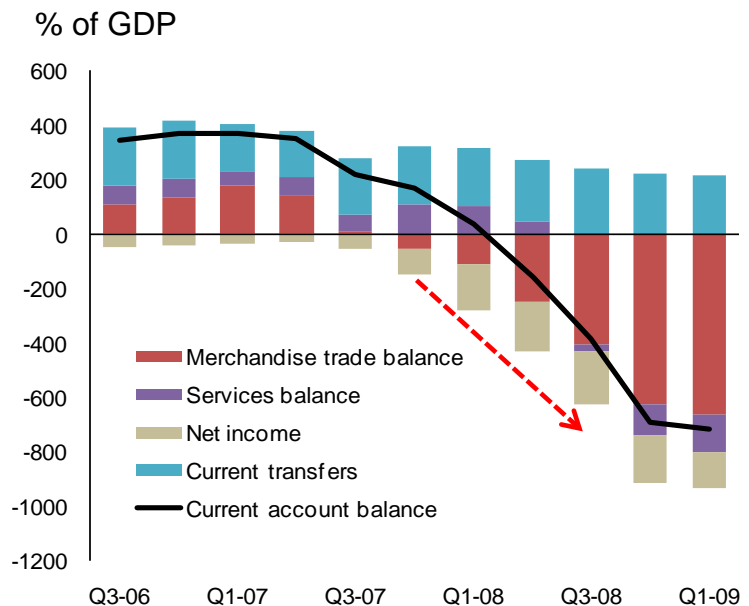
CPI inflation, 2007-2008



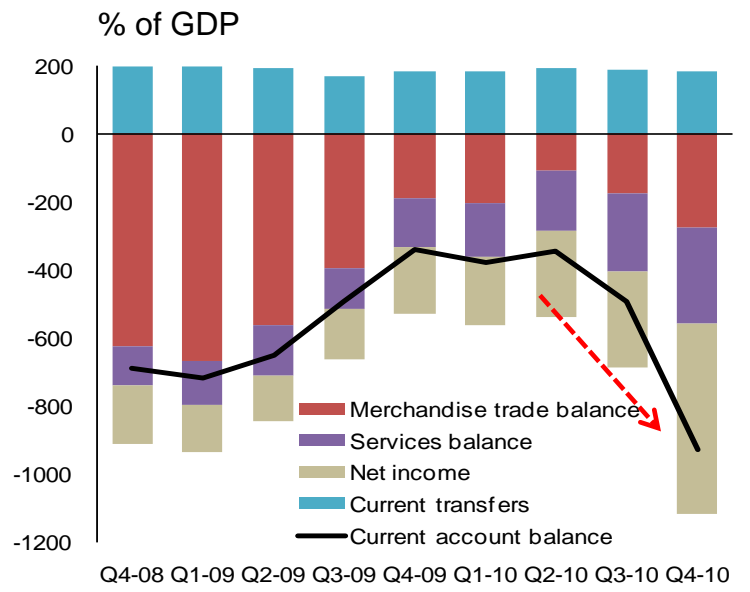
CPI inflation, 2009-2011



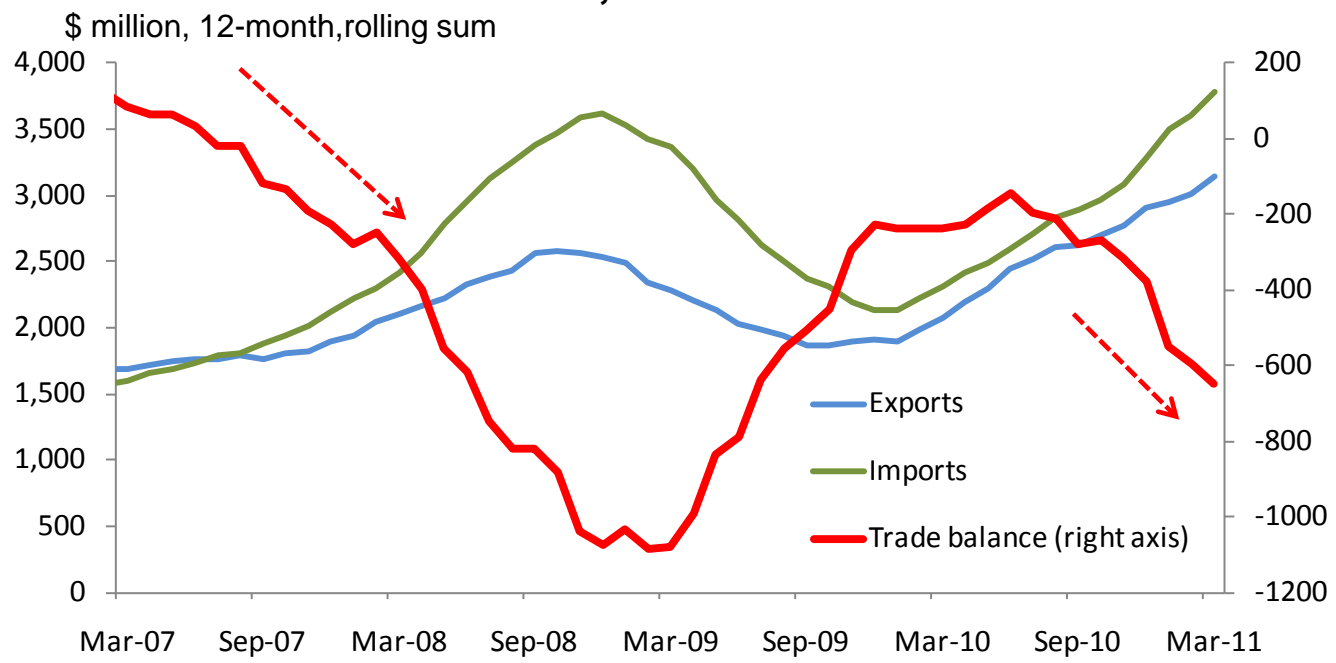
Current account, 2006-2008



Current account, 2008-2010



Trade Balance, 2006-2011



Policy challenges

- Fiscal Stability Law of 2010:
 - Comprehensive set of fiscal rules
 - while the structural balance rule only goes into effect in 2013, the spirit of the law should be implemented starting now
 - Why wait to fend off the Dutch Disease?
- draft Integrated Budget Law before Parliament in the Spring Session:
 - Budget implications of any new law need to be estimated and assessed by Ministry of Finance and Budget Standing Committee before a law can be passed
 - A budget amendment can only be submitted if, due to unforeseen circumstances, the unified budget deficit is increased by 3 percent of GDP
 - Restrains parliament....will it tie its own hands in the interest of macroeconomic stability?

We will see....