

Who benefits from high interest rates and an appreciated currency?

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The great majority of liberal economists mean no harm by promoting fiscal adjustment alone.

The Dutch disease and very high interest rates, which translate into a long-term appreciated exchange rate, are the two main causes of the near stagnation of the Brazilian economy since 1995 because, by making capital more expensive and removing the competitiveness of manufacturing firms, they discourage growth and deindustrialize the country.

The Dutch disease is a long-term overappreciation of the domestic currency that makes the manufacturing industry non-competitive even if the business firms use world state-of-the-art technology. It stems from the fact that commodities benefit from price booms or, simply, differential Ricardian rents disconnected from productivity, and, so, may be exported at an exchange rate substantially more appreciated than that needed to make the country's competent manufacturing firms also competitive.

High interest rates such as those found in Brazil and a long-term appreciated exchange rate are, both, the main causes of the lack of competitiveness of the manufacturing companies. By preventing investment, they also prevent growth, unless one should believe the absurd – that a country can develop without diversified and technologically sophisticated manufacturing and services sectors; that it can grow and become rich based only on commodities exports.

A young student recently asked me if the political opposition against neutralizing the Dutch disease originated from agribusiness, since, as I have been showing, the means to neutralize it is the adoption of a tax on commodities exports whose rate varies with international prices. But no: opposition against neutralizing the Dutch disease does not come from agribusiness. True, they will pay a tax, but will get back the same figure in the form of the devaluation of the Brazilian Real. This offset would take place automatically via the market, but can be assured by law.

Who, then, opposes low interest rates and a competitive exchange rate? They are the liberal economists, who defend the interests of rent-seeking capitalists (who live on interest, dividends and rent) and the heterodox vulgar developmentalists who mistakenly believe that they are defending the interests of workers or, more broadly, of wage-earners. Let us take a closer look at this political economy.

When the government devalues the national money (a once-and-for-all devaluation), workers and the rentier capitalists lose purchasing power – the purchasing power of workers' wages, and the purchasing power of rentiers' interests, rents on real-state, and dividends. But the loss ends there for workers and it is quickly made up for, as employment would soon resume with the return of growth, followed later by wages. Not so for rent-seekers. In addition to seeing their three forms of revenue reduced in real

terms, the value of their wealth would also be reduced. Furthermore, the reduced interest rate, which is as important as neutralizing the Dutch disease to make the domestic currency competitive, is certainly not in the best interests of rent-seekers. Lower interest rates nominally reduce interest income and devalue the stock of interest-paying wealth.

When interest rates are reduced and the Dutch disease is neutralized, the exchange rate depreciates and a current-account surplus emerges. Who stands to gain? Manufacturing businessmen directly because their firms will once again become profitable and they will resume investing. And all of society, indirectly, because the growth rate will be significantly higher than it has been in the past.

Yet liberal economists won't hear of exchange rates and current-account surpluses. As they are, directly or indirectly, a part of the financial sector that manages rent-seekers' wealth, they speak only of another ill (albeit a real one): high and pro-cyclic public deficits. They are, therefore, oddly contradictory. They will take current-account deficits, which are a clear sign of exchange-rate populism, even as they reject public deficits as a symptom of fiscal populism. They should be against the two kinds of deficit.

Liberal economists assume that the market and, therefore, the private sector, are always in equilibrium. For this reason, they believe that macroeconomic problems can only be fiscal in nature. Therefore, whenever macroeconomic maladjustment occurs their only response lies in fiscal adjustment. The alternative, new developmental, policy is, in addition to fiscal adjustment, to reduce the interest rate and depreciate the exchange rate.

There is a big difference between the two policies. The liberal one, which relies on fiscal adjustment alone, neither reduces enough the interest rates nor makes the currency fully competitive; does not balance either the fiscal or the current accounts; and its cost is borne by wage-earners alone. The new developmental policy, in its turn, sets interest and foreign exchange rates to their appropriate levels, reduces public deficit and produces a current account surplus; its cost is bone not by wage-earners alone, but by rent-seekers as well.

The large majority of liberal economists do not act out of ill will by promoting fiscal adjustment alone. Their theoretical training does not allow them to see the macroeconomic maladjustment except from the fiscal angle. What to say of heterodox economists who also reject depreciation and a current-account surplus? They fail to understand the different consequences of devaluation for wage earners on the one hand and rentier capitalists on the other. For this reason, they are poor representatives of workers' interests, whereas the liberals are good representatives of rentiers and financiers. Neither group properly represents the nation's interests.