

New Developmentalism and Developmental macroeconomics

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Two meanings of “developmentalism”

- ▶ A really existing **form of economic and political organization** of capitalism in between economic liberalism and statism or a growth oriented **style of economic policymaking**.
- ▶ **A theory** or a system of models aiming
 - ▶ (a) to explain economic growth with stability and
 - ▶ (b) offer policies that combine a moderate intervention of the state in the economy with market coordination.

New Developmentalism – Introduction

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As a really existing form of capitalism

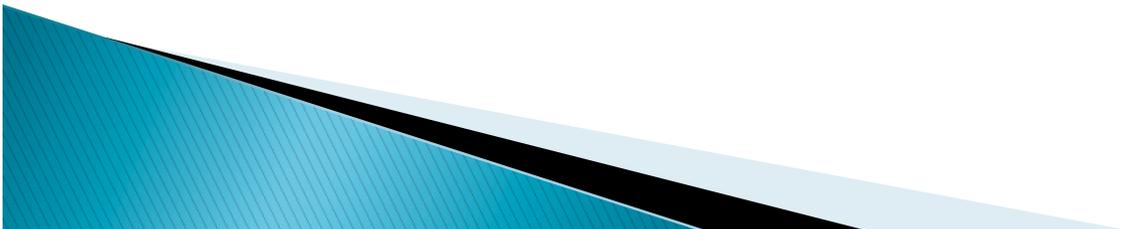
- ▶ Developmentalism was dominant in all **capitalist revolutions**, in four types of countries:
 1. Originally industrialized or central (like England and US);
 2. Central late industrialized (like Germany and Sweden);
 3. Independent late industrialized in the periphery (like South Korea and Taiwan);
 4. National-dependent late industrialized (like Brazil and Mexico).

As a theory

- ▶ **Classical developmentalism** (1940s–1960s) or development economics or structuralist Latin American growth theory, represented by Arthur Lewis, Ragnar Nurkse, Gunnar Myrdal, Raul Prebisch, Celso Furtado, Albert Hirschman and Michal Kalecki.
- ▶ **New developmentalism** (2000s – ...), represented by Bresser–Pereira, Roberto Frenkel, Gabriel Palma, José Antonio Ocampo, José Luis Oreiro, Nelson Marconi, André Nassif etc.

New Developmentalism

- ▶ It is a theoretical approach that **originates from**
 1. Classical Developmentalism or Development Economics and from Post–Keynesian macroeconomics
- ▶ It is **divided into**
 1. New–developmental macroeconomics
 2. New–developmental political economy
 3. New developmental microeconomics (just a draft)
- ▶ It is **focused** on middle income countries,
- ▶ whose key difference in relation to rich countries is that it gets indebted in **foreign money**.



Core concerns of the schools of thought

- ▶ **Marxist** –capital accumulation and the profit rate
- ▶ **Neoclassical** –fiscal deficit & interest rate, inflation,
- ▶ **Keynesian** –effective demand, countercyclical policies
- ▶ **Classical Developmentalism**: structural change & protectionism (industrial policy)
- ▶ **New Developmentalism**: macroeconomic prices, current account & exchange rate, exchange rate policy.



Preview of differences with classical developmentalism

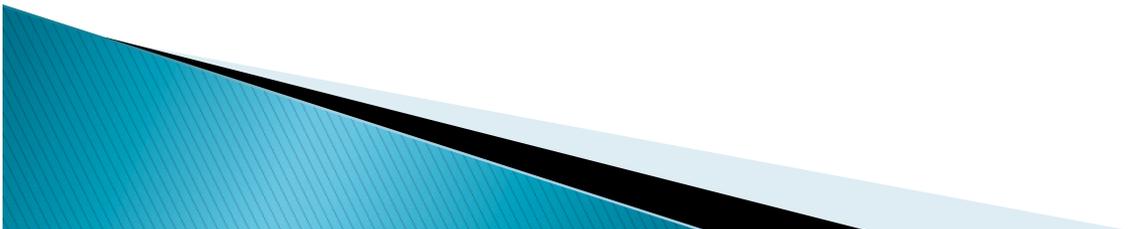
- ▶ Applies to middle-inc, not pre-industrial cs.
- ▶ Limits planning to the non-competitive sector.
- ▶ Industrial policy is no substitute for responsible macroeconomic policy.
- ▶ Has a macroeconomics that CD does not have

With Post-Keynesian Macroeconomics

Applies to middle-income, not rich countries

Has a growth theory

Is focused on the five macroeconomic prices



Diffs with Classical Developmentalism

Similarities

- ▶ Historical method.
- ▶ Development as structural change
- ▶ Tendency to deterioration of terms of trade
- ▶ Foreign constraint (two elasticities)
- ▶ Defends industrial policy.
- ▶ Defends trade-offs with distribution (and sustainability).

Differences

- ▶ Applies to middle-inc, not pre-industrial countries.
- ▶ Limits planning to the non-competitive sector.
- ▶ Industrial policy is no substitute for macro policy.
- ▶ Has a macroeconomics
- ▶ Tendency to the cyclical and chronic vaorization of the exchange rate
- ▶ Critical of “foreign savings”

Differs with Post-Keynesian Macro

Similarities

- ▶ Historical method
- ▶ Tendency to the insufficiency of demand
- ▶ Investment determines savings
- ▶ Foreign constraining (Thirlwall law)

Differences

- ▶ Applies to middle-inc, not rich countries.
- ▶ Focused on the exchange rate & the current acc, not in the interest rate & fiscal acc
- ▶ Focused in the five macro prices
- ▶ Critical of “foreign savings”.
- ▶ PK – no growth model (Thirlwall law is not)

Orthodox populism and vulgar Keynesianism

▶ Populisms

1. Political

2. Economic:

– **exchange rate populism**: high current–account deficits; the nation–state (private and public) expends irresponsibly

– **fiscal populism**: high fiscal deficits; the state expends irresponsibly

▶ **Orthodox populism**: exchange rate populism

▶ **Vulgar Keynesianism (or heterodox populism)**: fiscal as well as exchange rate populism.

Differences with Orthodox Populism or Heterodox Populism

- ▶ Defends **zero or surplus** current-accounts;
- ▶ Defends small budget deficits; expansive fiscal policy only when clearly procyclical p
- ▶ **Does not** make trade-offs between exchange rate and either
 1. short-term wages (heterodox populism)
 2. or inflation (orthodox populism)
- ▶ **Distribution** is to be achieved through the tax burden and its progressiveness, not through exchange rate populism or vulgar Keynesianism.

ND It rejects the hypothetical–deductive method

- ▶ which is valid for methodological sciences as mathematics, econometrics and economic decision making theory, not for a social **substantive** sciences as economics is.
- ▶ Thus, don't accept predictions just based on the homo economicus or rational consistency.

Yet, ND accepts some economic theorems

- ▶ It accepts some **economic theorems** or simple, like the the Balassa–Samuelson or productivity–exchange rate effect and the PPP,– although they lead to opposite conclusions.
- ▶ Accept them **understanding** that they are just “consistency reasoning” from which one cannot predict and define policy.
- ▶ To define policy would represent to fall in the Schumpeter’s “Ricardian vice”.

ND adopts the historical-deductive method

- ▶ This was the method of Smith, Marx and Keynes
- ▶ It generalizes out of regular or repetitive behavior and historical tendencies inductively observed (and checks if they are reasonably rational or explainable).
- ▶ The **historical models** don't lead to certitudes, or precise predictions but to claims with adverbs like "**generally**".
- ▶ But from them one is able to **derive policy**.

Developmental Macroeconomics

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Growth is increase of productivity or industrialization or structural change or productive sophistication

- ▶ Increase of productivity may take place either
 1. In the same goods and services, or
 2. Transferring labor to more sophisticated (more valued added per capita, high wages) industries.
- ▶ Ec development or growth is the historical process of capital accumulation with incorporation of technical progress that increases standards of living durably.

The increase of productivity depends

- ▶ A. On the **supply side**, on education, science and technology, on entrepreneurs able to innovate, on investments in infrastructure, etc.
- ▶ B. On the **demand side**, on investment, which depends on the interest rate or cost of capital and on satisfactory expected rate of profit, which depends **on A** and on the **exchange rate**, if it tends to be overvalued in the long-term.
- ▶ On **the supply side**, the required policies are many, countries are usually making their best, and outcomes are lengthy.
- ▶ On **the demand side**, the required policies are simple, policymaker ignore which policies adopt, but when they adopt the right policies, the outcomes happen in the short-term.
- ▶ **Besides**, innovation and increase in productivity are embedded in investment.

Growth is demand led

- ▶ It depends on investments, which depends on the expected profit rate, and of the exchange rate – the price that gives access to demand.
- ▶ and is constrained by the growth of exports.
- ▶ The **supply factors**, as education, technical progress and good institutions, are essential, but are embedded into capital accumulation, and have only long-term effects.

The five “right” macroeconomic prices

Quite different from neoclassical “right prices”.

PRICES	THEY ARE RIGHT WHEN
Profit rate	Satisfying
Exchange rate	Assures satisfactory profit rate to competent firms
Interest rate	Low level, around which to conduct monetary policy
Wages	Consistent with satisfying profit rate (growing with productivity)
Inflation	Below one digit

Investment function

- ▶ **Classical school**: investment depends on the expected profit rate and on the interest rate;
- ▶ **Keynes**: OK, but the expected profit rate depend on **demand**, which is not assured by the market.
- ▶ **New developmentalism**: OK, but firms must have **access to demand**, which is not assured by the market, but by a competitive exchange rate.

Why investment depends on the exchange rate?

$$I = (r, j, D, e)$$

- ▶ Because the exchange rate in developing countries is overvalued in the **long-term**, only depreciating in financial crises .
- ▶ While overvalued it does not give **access** to existing demand.
- ▶ When firms make their **calculi** on a given investment, they consider the overvalued currency, and don't invest.

The tendency to the overvaluation

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Why the exchange rate is overvalued in the long-term, only depreciating in the cyclical financial crises?

Because, in developing countries, there is a **tendency** to the cyclical and chronic overvaluation of the exchange rate.

This is **the core** empirical thesis of new developmentalism.

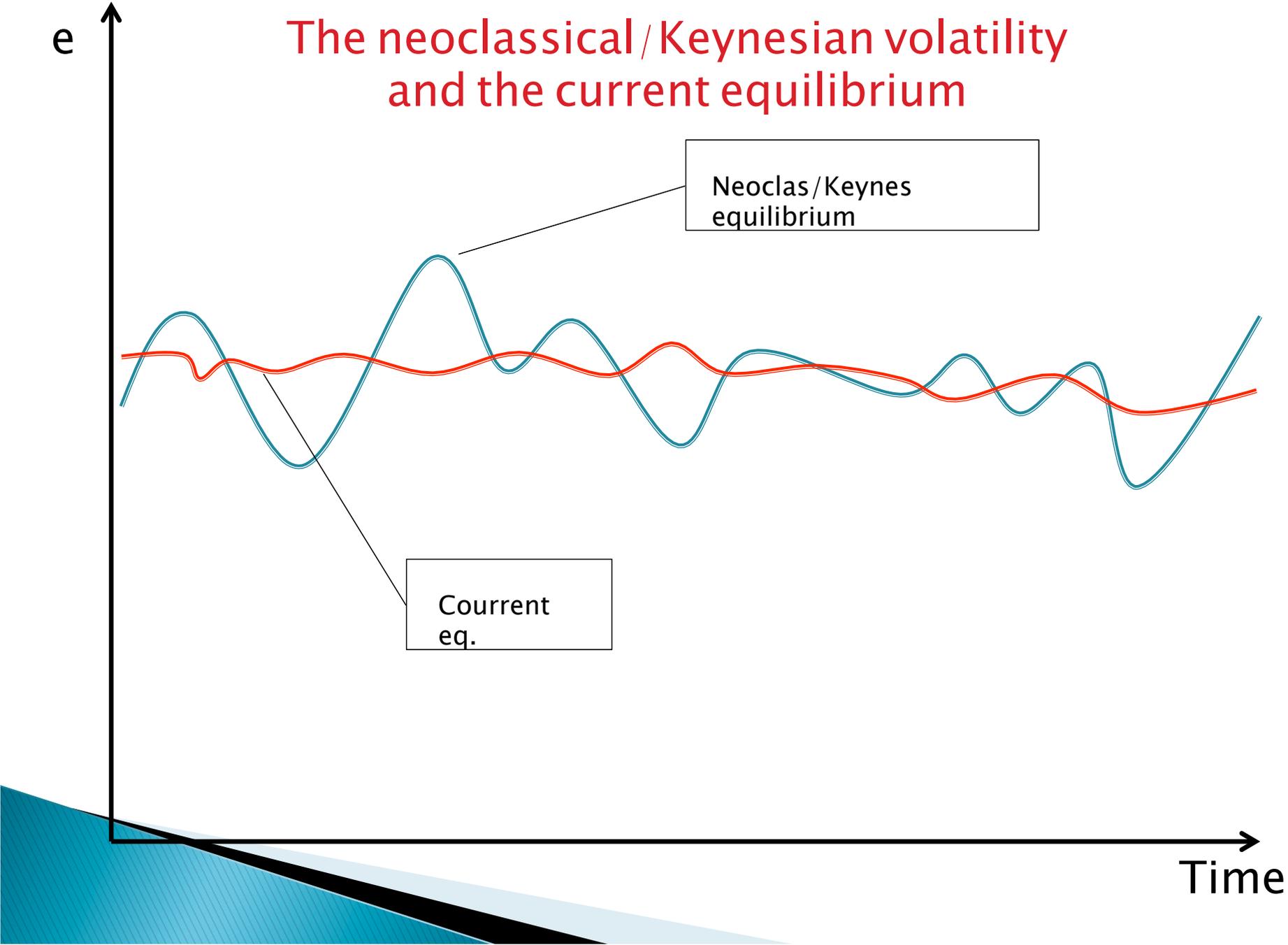
Historical tendencies & Tendency to the overvaluation of the ER

- ▶ **Classical school**: tendency to the falling rate of profit.
- ▶ **Keynes**: tendency to the insufficiency of demand.
- ▶ **Classical developmentalism**: tendency to the deterioration of term of change.
- ▶ **New-developmentalism**: tendency to the cyclical and chronic (long-term) appreciation of the exchange rate.
- ▶ (Neoclassical economics does not have a tendency because it is not historical.)

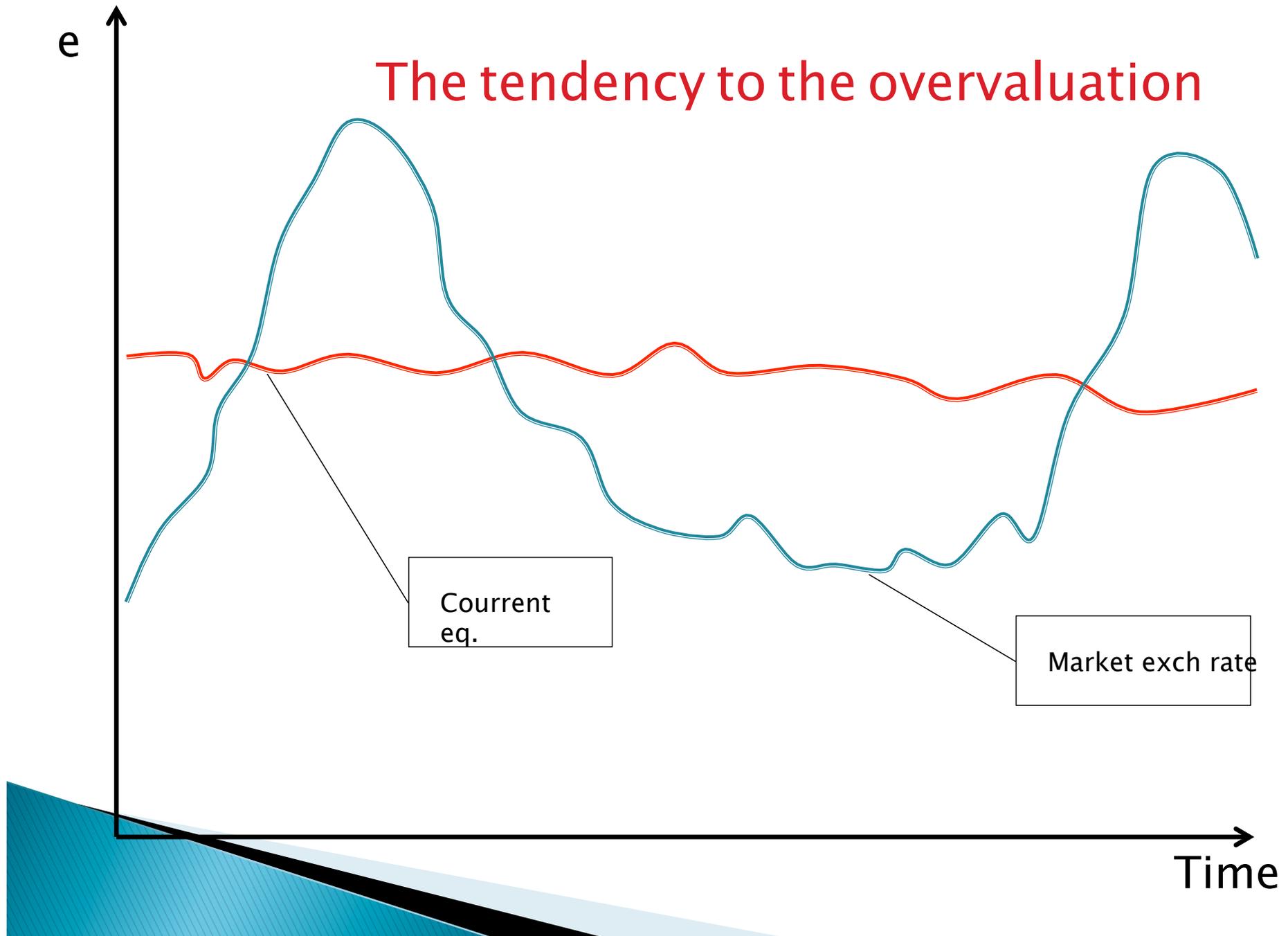
Do not confuse misalignments with the tendency to overvaluation

- ▶ **Neoclassical school** – small misalignments of the exchange rate
- ▶ **Keynesian school** – large misalignments
- ▶ **New-developmentalism** – tendency to the long-term overvaluation followed by cyclical currency crises.

The neoclassical / Keynesian volatility and the current equilibrium



The tendency to the overvaluation



Causes of the tendency to the overvaluation

- ▶ **Dutch disease**, which just pulls the exchange rate to the current equilibrium
- ▶ Three **habitual policies**, which explain the deficits.
 1. Growth with foreign borrowing (“foreign savings”)
 2. High level interest rate around which conduce monetary policy.
 3. Exchange rate anchor policy to control inflation.
- ▶ The habitual policies are the cause of the **cyclical crises**.

Habitual policy 1: Growth with foreign borrowing (“foreign savings”)

It is policy recommended by the liberal-orthodoxy and gladly accepted by the local populists, either orthodox and heterodox. It involves exchange rate populism.

It is supposed to increase total savings and investments, but actually replace them, and what we have usually is a high rate of substitution of foreign for domestic savings. Only in special circumstances, when the country is growing fast and the marginal propensity to consume falls, such rate is low.

Habitual policy 2: High level of the interest rates

- ▶ The level of the interest rate is the base around which the central banks manages monetary policy.
- ▶ The high level is justified either with the argument that it aims to attract capitals (Habitual policy 1) or to control inflation (Habitual policy 2)

Habitual policy 3: Exchange rate anchor to control inflation

- ▶ It is as usual as perverse.
- ▶ It is worse than to control the prices of state-owned enterprises to control inflation.
- ▶ Demand inflation is supposed to be controlled by monetary and fiscal policy and by prudential policies.

Dutch disease

- ▶ It is competitive disadvantage, long-term overvaluation of the exchange rate that stems from exports of commodities that, benefiting from Ricardian rents and/or from a commodity boom, can be exported with a profit at an exchange rate (current equilibrium) substantially more appreciated than the one required for the other tradeable firms that utilize technology in the world state of the art (industrial equilibrium).
- ▶ It is a major cause of non-industrialization if is not neutralized, or a major cause of deindustrialization if it was neutralized and is not anymore.

Thus, in the DD there are two exchange rate equilibriums

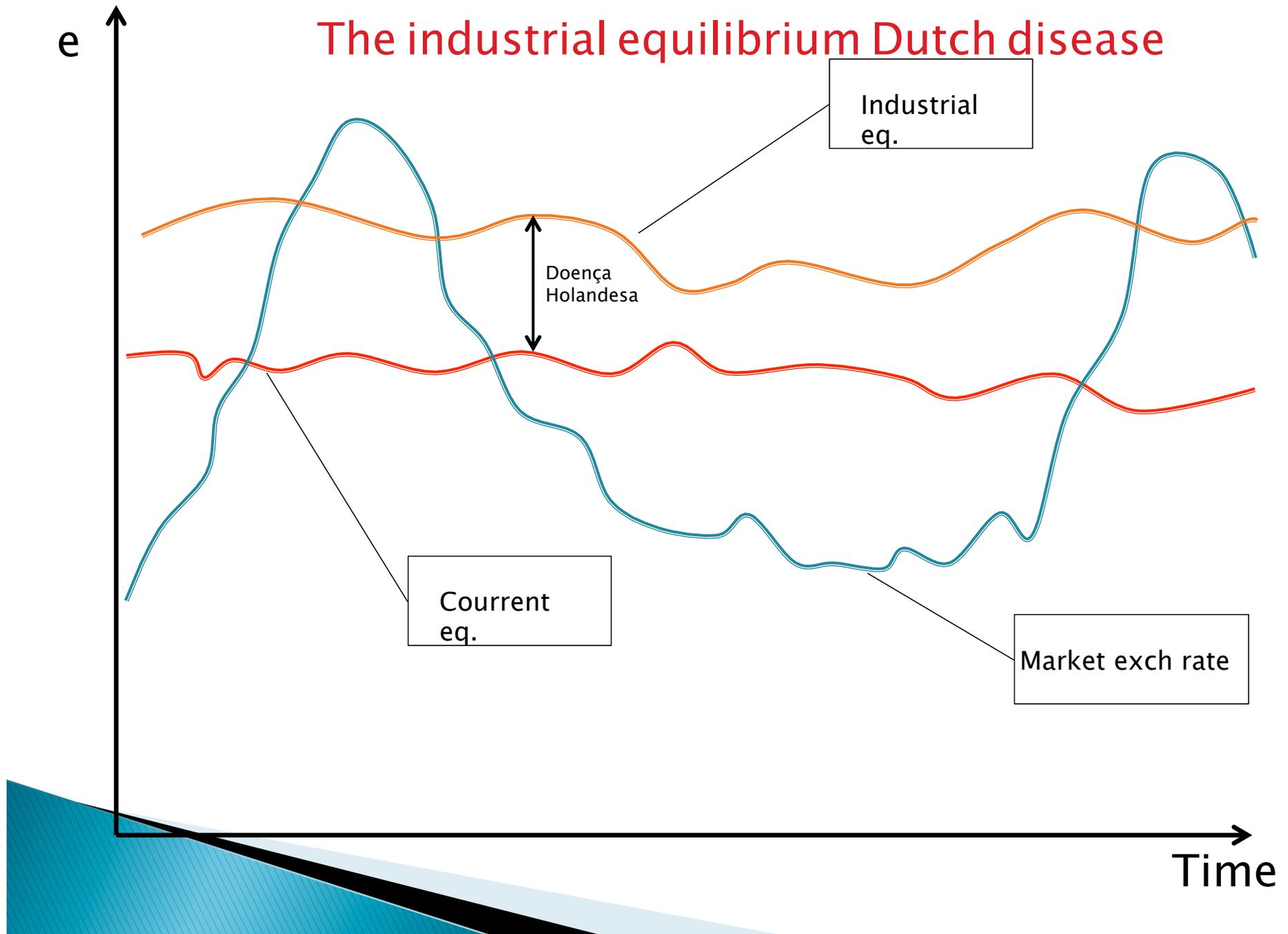
- ▶ **Current equilibrium** – value that balances intertemporally the current–account. It expresses the **value** of the foreign money.
- ▶ **Industrial equilibrium** – value that makes competitive the firms that utilize technology in the world state of the art. (Belongs to the Dutch disease model).
- ▶ There is a third, not related to the Dutch disease:
Foreign debt equilibrium – exchange rate that corresponds to a current–account deficit that stabilizes the foreign debt / GDP ratio. (Belongs to the financial crisis model)

Severity of the Dutch disease

Severity

- ▶ It is equal to the distance between the current and the industrial equilibrium.
 - ▶ $g = (e_i - e_c) / e_c$

The industrial equilibrium Dutch disease



The the value and the price of the exchange rate

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The value of the exchange rate (or foreign money)

The foreign money, as other goods and services, has a **value and a price**.

The value of a good is equal to the cost of production including a reasonable profit.

The **value of the exchange rate** is the value that covers the **cost of production** of the firms that participate from the foreign trade of the country and balances the current account.

.

Variation of the value

- ▶ It **varies** according to the **CULCI** – comparative unit labor cost index.
- ▶ $ULC = \text{wages} / \text{productivity}$
- ▶ For long we, economists, were aware that
 1. the CULCI is determinant of the exchange rate; and
 2. the CULCI defines the **“internal”** exchange. rate
- ▶ But we did not know why.
- ▶ Now – with the the concept of the value of the exchange rate – we know.
- ▶ When the CULCI or the value increases, the exchange rate depreciates (goes up).

The current equilibrium depends on

1. The **value** of the exchange rate, because its price floats around the value. When the value increases, the current equilibrium goes up, and the exchange rate depreciates.

2. The terms of trade

- ▶ Because the balance of the current account varies according to the terms of trade.
- ▶ When the terms of trade improve, the current equilibrium falls, and the exchange rate appreciates.

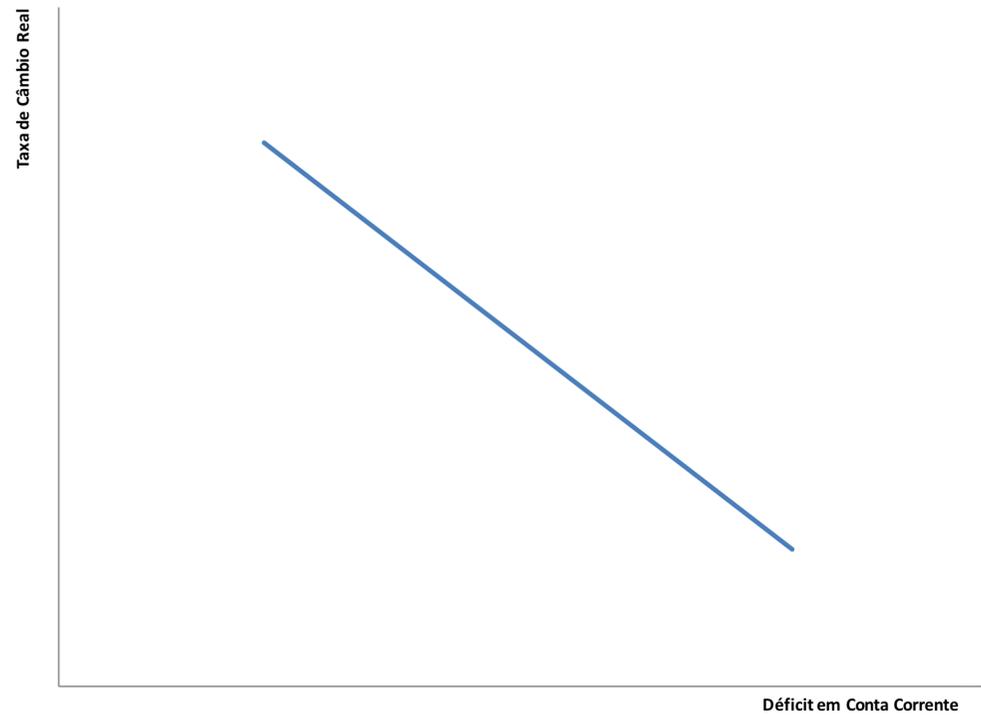
A compensatory mechanism

- ▶ The current equilibrium is the outcome of a “compensatory mechanism”.
- ▶ When the value increases, the current equilibrium goes up, and the exchange rate depreciates compensatorily. And vice versa.
- ▶ When the terms of trade deteriorate, the current equilibrium goes up, and the exchange rate also depreciates compensatorily. And vice-versa.

Understanding the line on time of current equilibrium,

- ▶ .
- ▶ The more valorized the exchange rate, the larger the current-account deficit, and vice-versa.

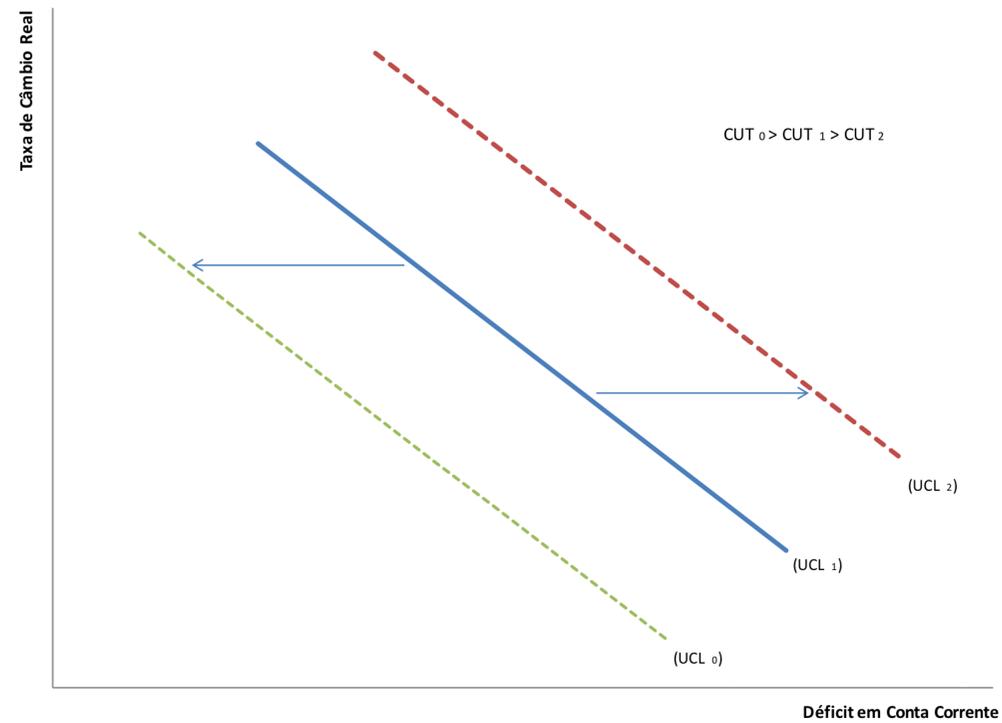
There is an inverse relation between the current account and the exchange rate



But the CA-ER relation varies

- ▶ If this relation was fixed, the current equilibrium through time would be a **horizontal line**.
- ▶ As the CA-ER relation varies according to the value or the terms of trade, such variation involve shifts in that relation, which make the current equilibrium equilibrium line on time to go up and down.

The current equilibrium varies according to shifts in the exchange-rate – current account relation



The price of the foreign money (exchange rate) depends

1. On current equilibrium (the value of the foreign money and the terms of trade), floating around it.
2. Such flotation depends on the demand and supply of foreign money.
 - ▶ **When the CULCI increases**, the value or current equilibrium increases (or its timeline of the current equilibrium goes up), and, so, the exchange rate falls or depreciates compensatorily;
 - ▶ **When the terms of trade improve**, the current equilibrium also increases, and, so, the exchange rate falls or depreciates compensatorily.

The demand and supply of foreign money depend

- ▶ **On the text–book variables:** interest rate differences, terms of trade, capital inflows and outflows, confidence, existence or no of capital controls, etc., and
- ▶ On the already referred **three habitual policies** which systematically appreciate the national currency of the developing country.

When there is Dutch disease

The current equilibrium depends

- ▶ secondarily, on the value of the exchange rate, which varies according to the CULCI;
- ▶ primarily, on the terms of trade of the commodities,
- ▶ because their international price varies a lot, while their CULCI varies much less.

The industrial equilibrium depends

- ▶ primarily, on the value of the exchange rate, which varies according to the CULCI;
- ▶ secondarily, on the terms of trade,
- ▶ because the international prices of the non-commodity tradable goods vary less than the respective CULCI.

The price of the exchange rate floats around the current equilibrium

Cyclical currency crises and financialization

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Types of financial crises

- ▶ Financial crisis are crises of excessive indebtedness.
- ▶ Two types:
- ▶ **Banking crises** – typical of rich countries that get indebted in their own money;
- ▶ **Currency or balance of payment crises** – typical and chronic in developing countries, which get indebted in foreign money (that they cannot either issue or depreciate).
- ▶ Currency crises are also **sovereignty crises**.

Currency crises suppose financialization

- ▶ I am always assuming a floating regime.
- ▶ In a floating regime, currency crises would be **impossible**, because as soon as they country entered the realm of current account deficits the exchange rate would devalue and the equilibrium would be warranted.
- ▶ Nevertheless, they happen because **the long-term overvaluation phase** is only possible if there is financialization – specifically a credit bubble.
- ▶ (I am defining financialization as an economy of financial innovations, fraud and bubbles.

Would budget deficits be the cause? The twin deficits?

- ▶ Liberal orthodoxy defends that financial crises are caused by fiscal irresponsibility.
- ▶ And supposes the twin deficits: when the fiscal deficit increases the current account deficit also increases.
- ▶ But this is only true if the exchange rate is balanced.
- ▶ When it is overvalued – as it usually is in developing countries – the country may present a balanced budget and a high current account deficit.

The cause of currency crises are the desired current account deficits

- ▶ The Dutch disease does not explain them.
- ▶ The budget deficits are a cause, but not the main one.
- ▶ The main cause is the policy of **growth cum current account deficits** (“foreign savings”) and increased foreign indebtedness which is financed with loans in foreign money.
- ▶ When the market exchange rate reaches **the bottom** and stays there for a long time, the foreign debt increases, and, eventually, the foreign creditors lose confidence, suspend the roll-over of the debt, and the crisis breaks up.

A third equilibrium

- ▶ Proposed by liberal_orthodoxy.
- ▶ Which would make the growth with current account deficits consistent with financial stability.
- ▶ Liberal orthodoxy (John Williamson) calls it the “fundamental” rate.
- ▶ I call “foreign debt equilibrium”.

The foreign debt equilibrium

- ▶ **Def:** the foreign debt equilibrium is the exchange rate that corresponds to CAD in relation to GDP equal to the rate of growth of GDP.
- ▶ The foreign debt equilibrium corresponds loosely to what Williamson calls “**fundamental exchange rate**”.
- ▶ Economists in general recommend it, while new developmentalism rejects it.

Summing up

- ▶ There is a tendency to to the long-term overvaluation of the exchange rate caused by the Dutch disease and three habitual policies.
- ▶ Such overvaluation is interrupted by the three habitual policies which appreciate the currency, lead the country to current account deficits, and are resolved into currency crises.
- ▶ The Dutch disease plus the three habitual policies are the causes of non-industrialization, and of low growth.

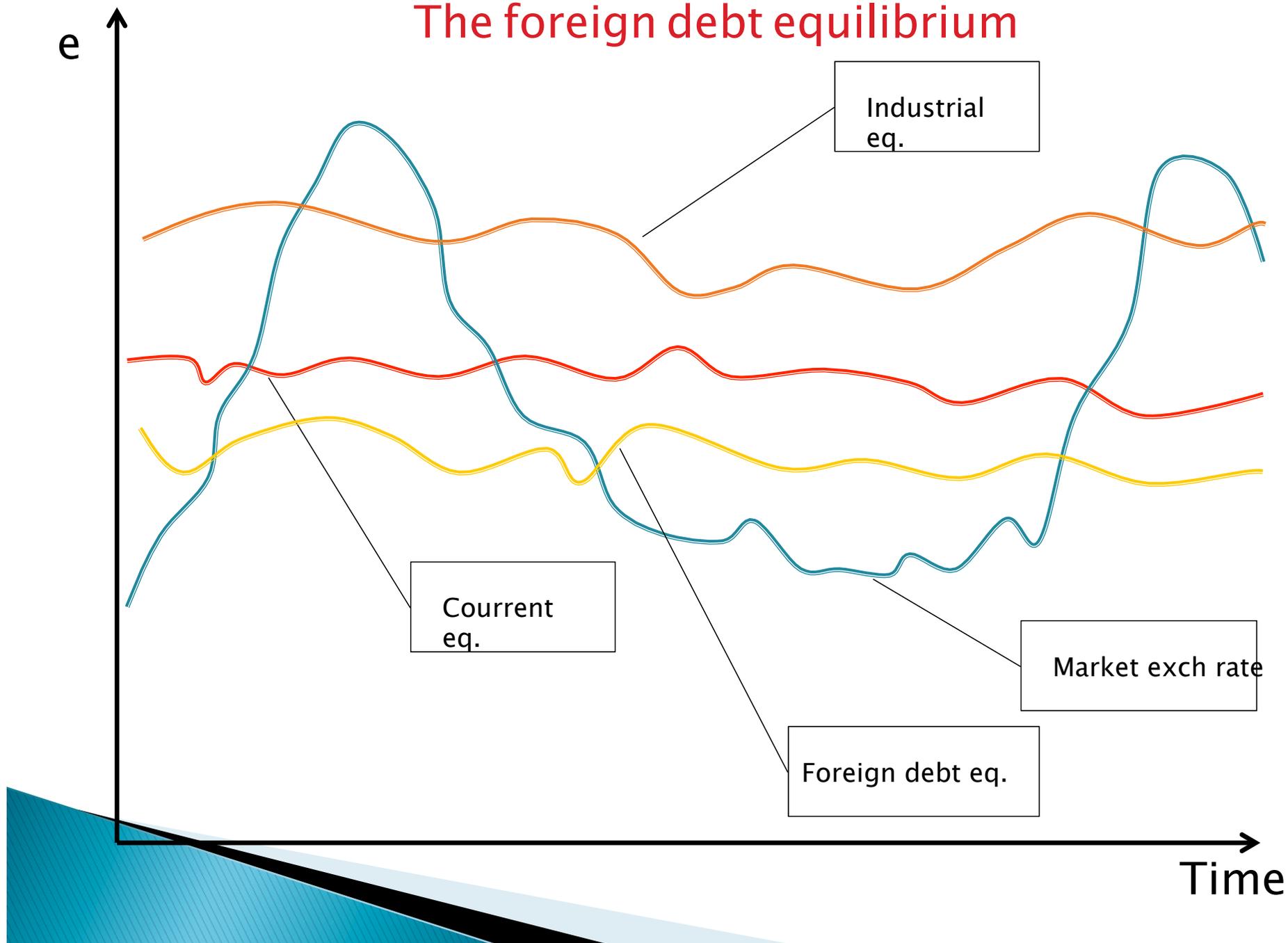
Note the huge difference in recommended exchange rates

1. For new developmentalism: **the industrial equilibrium.**
2. For the orthodoxy and for populists: the **foreign debt equilibrium (FDE).**

The country that has the DD and accepts the FDE is condemned to export commodities, because its prices will be wrong.

1. The exchange rate will be overvalued
2. The expected profit rate will be depressed
3. All revenues will be artificially high

The foreign debt equilibrium



For each country we have

- ▶ Industrial equilibrium
- ▶ Current equilibrium
- ▶ Foreign debt equilibrium
- ▶ Exchange rate price, which is below the FDE when the country is in the phase of long-term overvaluation.

Example of recent Brazil: 2007-13

- ▶ The industrial equilibrium R\$ 3.80
- ▶ Dutch disease $-R\$0.80 = 27\%$
- ▶ The current equilibrium R\$ 3.00
- ▶ Three habitual policies $+R\$ 0.50 = 17\%$
- ▶ Average exchange-rate price R\$ 2.50
- ▶ Overvaluation $R\$ 1.30 = 43\%$

(Approximate numbers at December
2015 prices)

Macroeconomic policies

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Policy objectives

1. Economic growth leading to gradual catching up.
 2. Reduction of inequalities..
 3. Control of climate change.
- ▶ The main objective remains growth.
 - ▶ Trade-offs between the three objectives are inevitable.
 - ▶ But I believe that they are less contradictory than is usually thought.

1. Distributive policy

- ▶ Minimum wage
 - ▶ Welfare state
 - ▶ Progressive taxation.
-
- ▶ The progressive taxation should select or privilege **rentier capitalists**, which have no contribution to production and growth.

Mistakes related to economic inequality

- ▶ Improvement of equality should not be achieved through expansive macro policies. The main object of macroeconomic policy is not distribution but full employment and growth.
- ▶ Artificially high wages caused by overvaluation are not sustainable.
- ▶ Increase the richs' revenues does not trickle down growth.

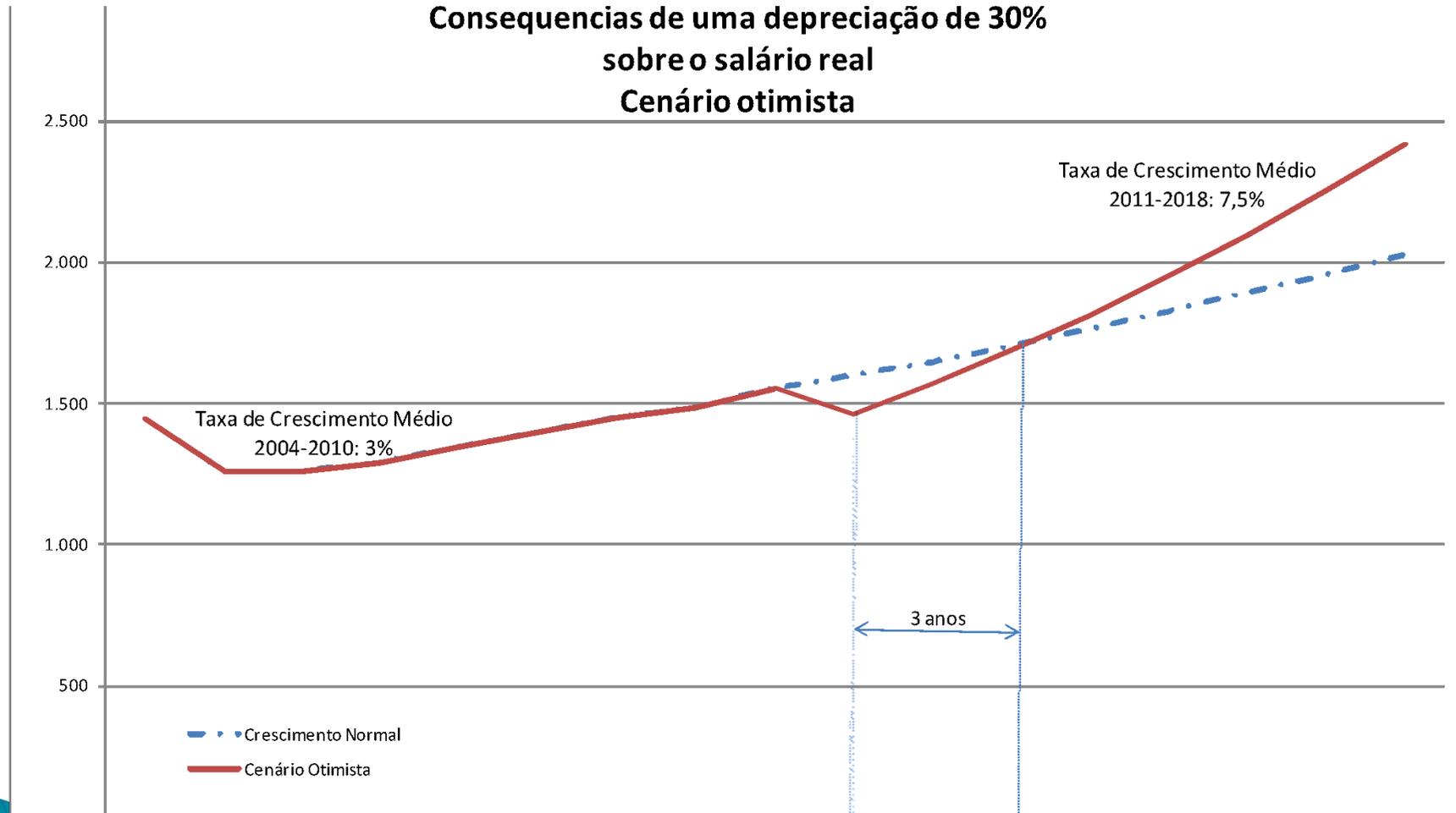
Gini coefficient before and after taxes

(mid 2000s)

	Before taxes & transfers	After taxes & transfers	Variation %
Sweden	0.49	0.23	38.8
Germany	0.44	0.28	27.3
USA	0.46	0.34	26.1

Consequence of depreciation on wages

Consequencias de uma depreciação de 30% sobre o salário real
Cenário otimista



2. The environmental challenge

- ▶ Climate change is a major threat to hummanity.
- ▶ But developing countries (and may be also rich countries) cannot give up growth.
- ▶ The challenge is to develop energy saving technologies that make consistent growth with improvement of the environment and control on the climate.
- ▶ This requires investments that are happening for some time.
- ▶ It is significant that you need investment capacity (wealth) to invest in renewable carbon free technologies.

3. Growth with stability strategy

- ▶ To keep the five macroeconomic prices **right**.
- ▶ To reject exchange rate and fiscal **populism**:
 1. **Foreign accounts**: zero or surplus proportional to the severity of the DD;
 2. **Budget deficit**: small.
- ▶ To increase public savings.
- ▶ To invest in the infrastructure and in the other long-term supply side variables.

Exchange rate policy: two neutralizations

1. To neutralize the DD,
 - by imposing an **export tax** on commodities
2. To neutralize the tendency to the overvaluation of the exchange rate.
 - by, additionnally, **rejecting the three habitual policies**
 1. Growth with foreign borrowing (“savings”)
 2. High level interest rate
 3. Exchange rate anchor policy to control inflation
 - ▶ **To control capital flows** when needed

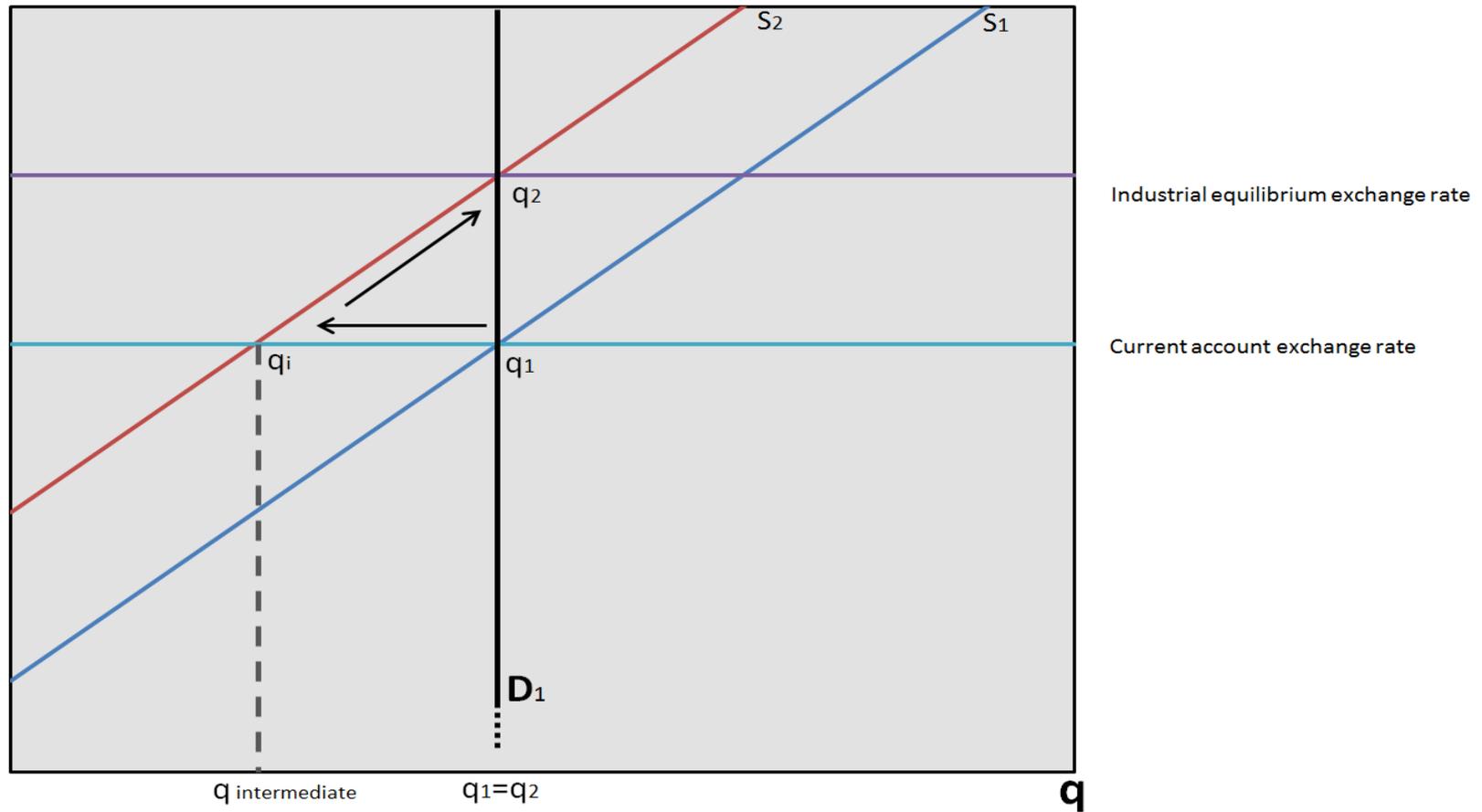
Rejecting the growth with foreign borrowing also?

- ▶ Yes, it is because, generally, foreign savings **don't add** to domestic savings.
- ▶ There is a **high rate of substitution** of foreign for domestic rates, except when the country is growing very fast and the marginal propensity to consume falls.
- ▶ **Cause**: when the country decides “to grow with foreign savings”, it incurs in current-account deficit, the exchange rate appreciate, investments and desencouraged, and domestic savings fall.
- ▶ Also a cause on the supply side: the appreciation increases revenues, increases consumption, domestic savings fall.

Neutralization of the Dutch disease

- ▶ A **variable export-tax** equal to the severity of the Dutch disease will neutralize it, making the current and the industrial equilibriums equal.
- ▶ Because:
 1. Increase the value, i.e., the cost + profit.
 2. Shifts the supply curve to the left.
- ▶ In the previous example, today the tax would be zero, between 2007–2017, would be, R\$ 0.80 per US\$ (December 2008 prices).

Neutralization of the Dutch disease by shifting the supply curve



Some economic consequences of the exchange rate policy

1. Satisfactory profit rate
 2. Increase of the investment rate.
 3. Current-account surplus.
 4. Faster growth
 5. Faster growth of wages.
 6. Reduction of inequality.
- ▶ **Note** that developing countries **don't need** foreign capital.
 - ▶ But the current account surplus depends on **rejecting** the three habitual policies, which are all equivocated, besides neutralizing the DD.

East Asian policies according to Ha-Joon

- ▶ Protection to infant industry: tariffs: in 1970s, 30–40%; in the 1980s, 20–30%; non-tariff barriers. Order: luxury, consumer, intermediate, capital goods.
- ▶ Huge export subsidies.
- ▶ Strict control of the exchange rate.
- ▶ Financial markets: heavily regulated.
- ▶ Low (usually negative) interest rate.
- ▶ Foreign capitals were heavily regulated,
- ▶ Inflation in Korea in the 1970s, 19.8%.

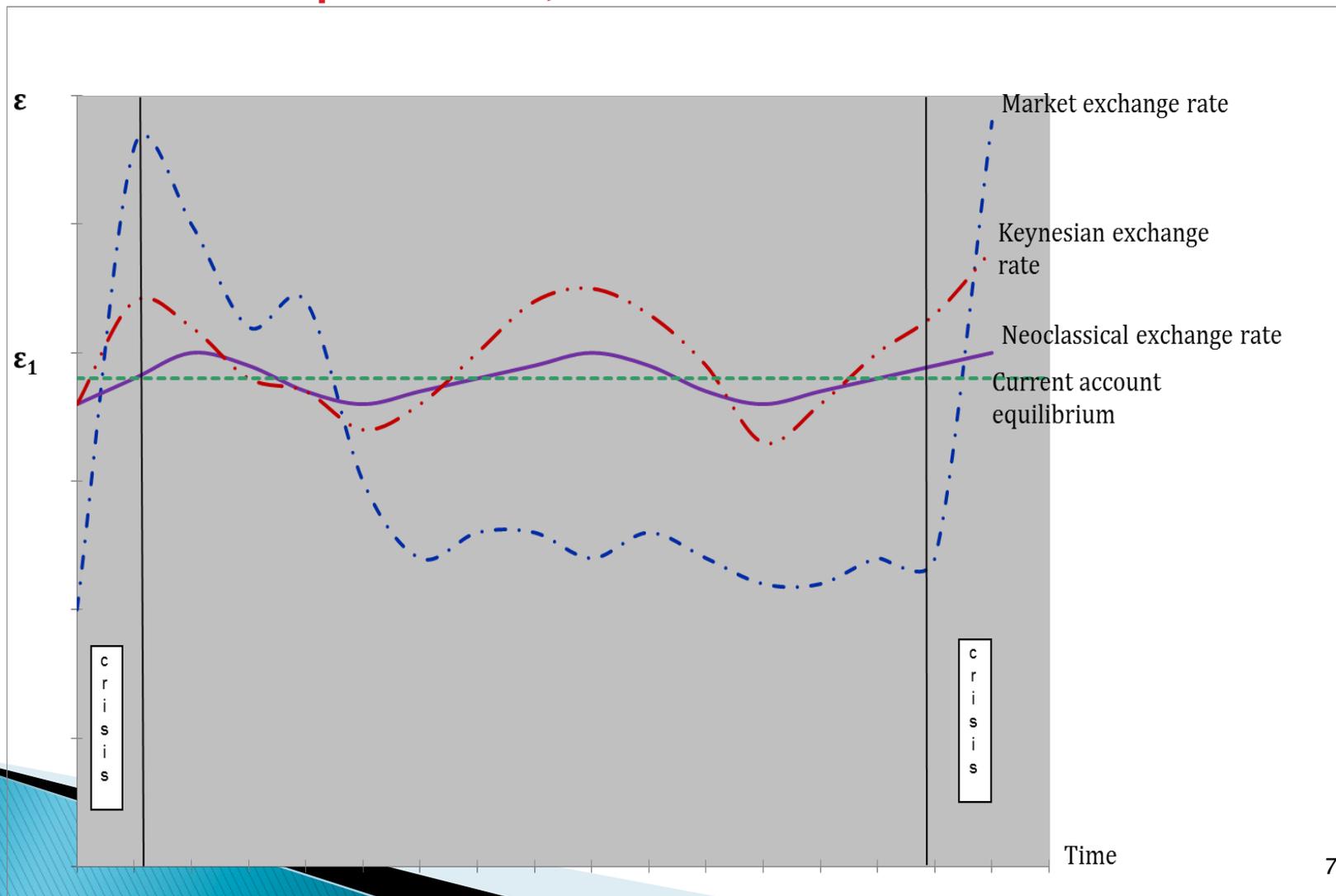
On New Developmentalism

- ▶ Bresser–Pereira, Luiz Carlos (2015) “Reflecting on new developmentalism and classical developmentalism”, *Working Paper EESP/FGV 395*, June 2015. Approved to be published in *Review of Keynesian Economics*. Available at www.bresserpereira.org.br.
- ▶ Bresser–Pereira, Luiz Carlos, José Luis Oreiro e Nelson Marconi (2014) *Developmental Macroeconomics*. London: Routledge.
- ▶ Bresser–Pereira, Luiz Carlos (2010) *Globalization and Competition*. New York: Cambridge University Press.

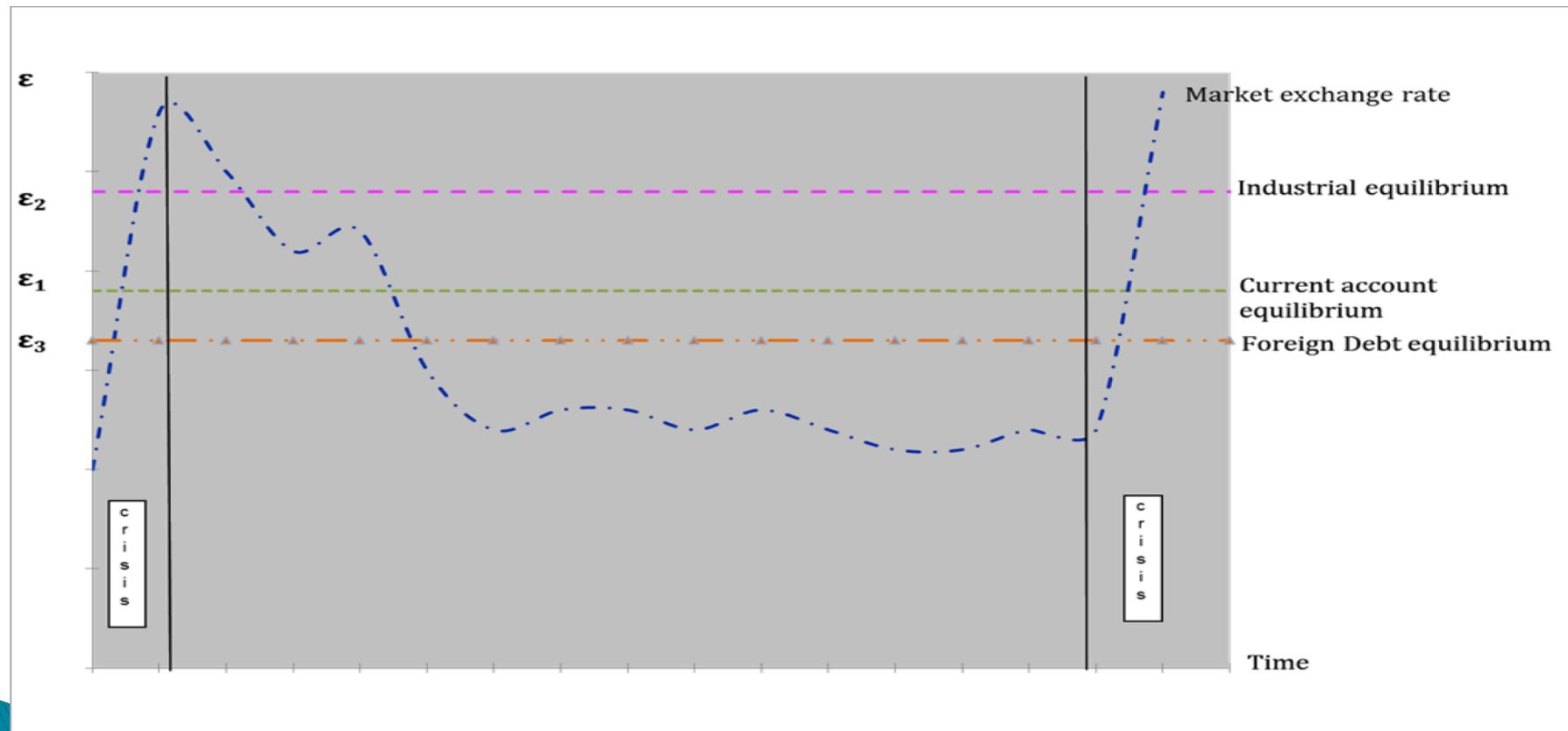
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Taxa de câmbio: um equilíbrio, três teorias



Tendência à sobreapreciação crônica e cíclica da taxa de câmbio



Main differences in relation to classical developmentalism and post-Keynesian macro

- ▶ It is focused in the five macro prices
- ▶ It is focused on the exchange rate, the current account deficit, and the expected profit rate.
- ▶ It is based on the tendency to the overvaluation.
- ▶ Its investment function includes the exchange rate, which tends to not give access to demand.
- ▶ Has a new model for the Dutch disease.
- ▶ Rejects growth with foreign savings.
- ▶ Defends an active exchange rate policy.
- ▶ Defends a manufactured goods export-led strategy.