Neo-Developmentalism, Currency Hierarchy and Policy Space in Emerging Economies: Can Sustainable Growth be Compatible with Income Redistribution?

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Abstract

The 2000s have brought a renewed debate on strategies of 'developmentalism' in emerging market economies. Neo-developmentalism is understood as a strategy in which the state deliberately pushes the process of development, in terms of structural change, and aims at income redistribution. In our paper, we first seek to systematize this debate, comparing the concepts of new developmentalism and social developmentalism. Second, we argue that of particular relevance for this discussion are the policy space constraints for emerging markets imposed by an international monetary asymmetry. We conclude that public policies to achieve sustained economic growth with income redistribution in emerging economies have to combine policies to reduce external vulnerabilities, especially financial shocks, with welfare policies that encompass income redistribution with a stabilization of domestic demand through the cycle.

JEL: B50 [Current heterodox approaches; general]; E61 [Policy Objectives, Policy Designs and Consistency, Policy Coordination]; F33 [International Monetary Arrangements and Institutions]; F63 [Economic Impacts of Globalization; Economic Development]; O11 [Macroeconomic Analyses of Economic Development]

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1. Introduction

The Latin American continent for a decade has experienced an unprecedented combination of vigorous growth and an impressive drop in income inequality, with indicators at levels not seen for quite some time in the region. Growth rates averaged 4.1% p.a. for the region as a whole from 2004-2013, as opposed to 2.7% p.a. for the period 1984-2003, according to IMF (2014). This recent growth with equity has been on the top of the policy agenda of the continent for this decade. It is also remarkable as it goes against the tendencies observed in all other regions around the world at the turn of this century. At the same time, the recent slowing down of this process, amplified by falling commodity prices since 2011 and intensified in 2014, has brought up the question if these positive trends can be seen as a result of a deliberated strategy or of a temporary boom of commodity prices and capital flows; in other words, if it was 'good policy or good luck', as Easterly *et al.* (1993) named it in an earlier context.

With Latin America at the crossroads, it is appropriate to take a closer look to the intensive debate on new strategies of developmentalism that emerged in this context on the background of profound discontent with 'Washington Consensus' style policies. Yet, this debate is far from being precise. As Fonseca (2014) demonstrates, the concept of developmentalism is related to a rather diffuse mixture of different theoretical assumptions and historical experiences. Moreover, it is important to clarify the multiple concepts used in this debate: a strategy refers as to a project of development, which encompass policies and institutions. The present paper aims at evaluating these new strategies of developmentalism on the background of an international asymmetry related to the global hierarchy of currencies, amplified by financial globalization. In particular we discuss the following questions: How does the hierarchical currency system (Cohen 1998, 2004, Eichengreen and Hausmann 2005) impose policy constraints to developmentalist strategies in their different modalities? What sort of macroeconomic policy agenda for a developmentalist strategy would be required in order to deal with this sort of policy constraints? What are the limits of these policies and strategies? Do such developmentalist strategies incorporate redistributive policies in a functional way for sustained growth and productive change?

We first introduce and distinguish between the two main recent strategies of developmentalism: the so-called new developmentalism (Bresser-Pereira *et al.* 2015, Oreiro 2012, see also Frenkel 2006 and Ocampo 2013) and social developmentalism (Bastos 2012, Bielschowsky 2012, Carneiro 2012, see also Amado and Mollo 2015). Our analysis shows that both strategies of neo-developmentalism seem to fail in their strategy to combine sustainable growth by structural change with income redistribution. While the variant of new developmentalism puts emphasis on aggregate demand created by net exports fostered by a competitive exchange rate, the social-developmentalist approach focuses on domestic demand created by wage increases and income redistribution. We argue that the latter does not consider appropriately the policy constraints related to currency hierarchy which reduces the space for the implementation of developmentalist policies, while the former sees redistribution as a mere result of export-led industrialization.

Consequently, we discuss how a developmentalist strategy has to be defined to combine sustainable economic growth with income redistribution imposed by the asymmetries of the hierarchical global monetary system. Our *main hypothesis* is that public policies to achieve sustained economic growth with income redistribution in emerging economies have to combine 'modern protectionism' with welfare policies that support crisis prevention. We define modern protectionism as a set of policies aiming to reduce external vulnerabilities through a combination of exchange rate policies seeking to prevent overvaluation, active foreign exchange reserve management, reduced reliance on external borrowing by using capital controls and macro prudential regulations, including those directly affecting capital flows. These should be complemented with active welfare policies that combine income redistribution with automatic stabilizers to smoothen domestic demand. We call this combination a '*peripheral Keynesian developmentalism*'.

2. New concepts of developmentalism

2.1. Concepts of developmentalism: A brief overview

The concept of developmentalism is a rather ambiguous term per definition. It involves two perspectives which obviously are intertwined, but not the same neither from an epistemological viewpoint nor in daily practice: i) a phenomenon of the 'material world', i.e. a set of practices of economic policies proposed and/or executed by policy makers, and ii) a phenomenon of the 'world of ideas', i.e. a set of ideas proposed to express theories, concepts or visions of the world. The former expresses itself also as political discourse, while the second seeks to form a school of thought (Fonseca 2014, p. 30 f.).

Much of the debate we are reviewing in this paper is intensively nurtured and intertwined with the economic policy discourse and policy making in many countries in Latin America by leftist governments, and especially in Brazil, a country which during the first decade of the 2000s raised the banner of growth with equity and designed a series of innovative macroeconomic and social policies (i.e. Ban 2013, Barbosa and Souza 2010). In this paper, we focus on the ideas and theoretical concepts which inspired these policies and were inspired by them at the same time. We will seek to detach it, as far as this is possible, from the concrete case of Brazil, while at the same time drawing heavily, even if not exclusively, on the rich and intensive debate within Brazilian academia.[1]

When seeking a proper definition of the term of developmentalism, a series of contributions (i.e. Amsden 2001, Cardoso and Faletto 1969, Chang 1999, Evans 1992, Schneider 1999, Wade 1990, see also the excellent literature review in Fonseca 2014) seek to work out the innovations found in the different variants of developmentalism. While many of them make reference to the original CEPAL contributions (i. e. Prebisch 1950),

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[1] Not occasionally these concepts have been most intensively discussed in the Brazilian context, as the two kinds of developmentalist strategies presume a certain level of economic development in terms of productive diversification, and at least some policy space. This type of economy often is defined as emerging economy. Here, we prefer the term 'peripheral emerging economy', to link it to our perspective of global monetary asymmetries and the specific constraints imposed to peripheral economies, especially when these have integrated themselves into global financial. markets via financial openness. At the same time, we will use the terms 'central' or 'advanced' and 'developing' as synonymous.

they are based on analysis of national economic strategies both in Asia and in Latin America during the post war period.

The most basic common denominator of this literature on developmentalism certainly is the perspective of (i) a national strategy or project of economic development, (ii) understood as structural change towards industrialization, (iii) giving the state an active role, and (iv) resulting in social transformation by inclusion into the labor market or public policies (Fonseca 2014, p. 41, and Bielschowsky 2015).

In the 2000s and 2010s, two (neo) developmentalist strategies emerged in Latin America, in particular in Brazil, as we will discuss in the next sections: new developmentalism and social developmentalism. Such strategies resulted from the profound discontent with 'Washington Consensus' style policies based on the liberalization of domestic markets, trade and financial openness and reduction of the role of the State in the economy, which had gained space especially in Latin America in the 1990s, but resulted in poor economic and social performance and the implementation of new strategies of development in Latin America and other regions.

2.2. Background: Developmentalism, old and new

The origin of the developmentalism is related both to studies of development of the 1950s (Rodestein-Rodan, Rostow, Lewis, among others) and the Latin American structuralism approach (Prebisch, Furtado, etc.), which sought to understand the specificities of underdevelopment and how to overcome it. As a phenomenon of the 'material world', developmentalism translated to national-developmentalist strategies supporting that industrial development was the most efficient way to achieve an increase in productivity and in national income, retaining the 'fruits' of technical progress in peripheral economies. Therefore, Latin American structuralism – also known nowadays as 'old developmentalism' – saw industrialization as the only way for these economies to overcome the constraints of the asymmetric international order and to gain access to part of the technical progress, allowing them to progressively raise the standard of living of the population (Prebisch 1950, see also Ocampo 2001b). Later CEPAL's works showed that even after some industrialization, Latin America reproduced the structural heterogeneity from the former agrarian-export period since industrialization did only modified its format: large segments of population, of the productive structure and of the geographic space were marginalized and apart from the modern segment of the economy (Pinto 1970).

Some updates of the structuralist approach have been conducted over the past two decades. CEPAL in the 1990s, in what was called 'neostructuralism', sought to regain the agenda of policies for development, adapting it to the new era of globalization. In general, such an agenda included: (i) new forms of state intervention, different from that prevailing in the past, with its actions focused on effectiveness and efficiency of the economic system as a whole; (ii) gradual and selective trade liberalization, as a means to boost technical progress and increase productivity combined with technology policies and training of human resources; (iii) a set of policies that seek to integrate growth, employment and social equity (Bielschowsky 1998).

During the 2000s and 2010s mostly Brazilian economists developed further approaches on developmentalism strategies known as 'new developmentalism' and 'social developmentalism'. Both have their origin in the structuralism approach, although oriented to semi-mature economies (featured by a more diversified productive structure and middle income).

New developmentalism shares the general lines of the neostructuralist perspective, but adds to this an agenda of developmental macroeconomic policies. Under this approach, there are two fundamental macroeconomic problems in middle-income countries: the tendency of wages to increase below the productivity rate, due to the availability of an unlimited supply of labor; and the tendency towards the overvaluation of the exchange rate[2], which is derived from two structural factors: (i) the problem of 'Dutch disease' in commodity exporters countries, which generates an appreciation trend of the domestic currency in the long run that is consistent with the balance in the current account but renders economically not viable other tradable industries[3]; (ii) an additional currency appreciation caused by net flows of foreign capital, stimulated by the policy of growth-cum-foreign savings.

Given these two trends, the new developmentalist strategy supports the implementation of an income policy that keeps wages growing in line with productivity, and an exchange rate policy that counteracts the tendency to currency overvaluation and that has as target an 'industrial equilibrium exchange rate'- which enables producers of state-of-the-art manufactured goods to compete in foreign markets with a fair profit margin (Bresser-Pereira 2011). According to this strategy, a developing economy must resort to an export-led strategy for a short time when the current growth rate is growing below the rate needed to perform the catching-up (see section 4). For this purpose it would be necessary to devalue the exchange rate to the level of competitive equilibrium, and this would lead to an increase in the profit rate and a temporary fall of wages (Bresser-Pereira *et al.* 2015). In a similar approach, Frenkel (2006) states that the preservation of a competitive and stable real exchange rate can be used as an intermediate target of macroeconomic policies oriented to employment and growth objectives.

On the contrary, according to the social-developmentalist approach, economic growth should be driven by the domestic mass market, 'which will be the more the better is the income distribution' and also by 'favorable outlook for public and private demand for investments in (economic and social) infrastructure' (Bielschowsky 2012, p. 730). In particular, the growth of the 'domestic mass market' should be stimulated both by the expansion of employment and improvement in the income distribution as a result of redistributive governmental policies (such as real increase in wages, especially the minimum wage, and expansion of social spending) and stimulus to consumer credit. Secondly, as a growth strategy based on mass consumption might lose momentum with the passage of time, the expansion would have to be completed or seconded by

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[2] An overvaluation of the exchange rate is synonymous of an overvaluation of the domestic currency only when the exchange rate is the price of the domestic currency (direct measure). Yet, these two terms are usually used as synonymous by the academia some peripheral emerging economies where the exchange rate is the price of the foreign currency (indirect measure).

[3] The pioneering work of Palma (2005) points out the 'Dutch disease' can be one of the sources of a de-industrialization process in developing economies.

autonomous investment, i.e. by public investment in economic and social infrastructure (Carneiro 2012, p. 775).

Regarding the exchange rate, contrary to new developmentalism, there is little attention beyond the argument that a non-devaluated exchange rate would facilitate both the import of capital goods (allowing the national capital to absorb technological progress) as well as contribute to maintain workers' wages purchasing power (due to stable domestic prices of tradable goods)[4]. The balance of payments' constraint would be mitigated both by export growth induced by scale effects and industrialization fostered by domestic demand, given the complementarity between domestic and foreign markets, supplemented by the expansion of the natural resource-intensive sector and its supply chains (Bastos 2012, Bielschowsky 2012).

Table 1 describes aims, targets and tools of the developmentalistm strategies: old developmentalism, social developmentalism, and new developmentalism. The agenda of old developmentalism is well known, and includes an active role of the state (state-owned firms, public banks to push the industrialization process, planning), trade protectionism, and external financing as complement of domestic finance. As we can see in Table 1, the social developmentalism agenda is closer to old developmentalism with its proposal of growth driven by domestic consumption and public investment, but broadens the scope of developmentalism policies towards the social dimension. While older versions see income redistribution more as an outcome of structural change, the social developmentalist approach gives social policies a prominent role (Lavinas and Simões 2015). Thus, traditional tools such as an active fiscal policy, trade protectionism and the central role given to public banks for financing the development, are complemented by active wage policies (mainly by increasing the minimum wage), social policies (social transfers such as minimum income programs), and stimulus to consumer credit, to boost domestic demand and achieve income redistribution. Industrialization is expected to be pushed up by growing domestic market demand and, as already pointed out, net exports growth is seen as complementary to domestic market.

While social developmentalism aims at implementing a strategy that combines growth with income redistribution, new developmentalism is more concerned to provide a strategy for middle-income economies to catch-up with developed economies[5]. For this purpose, the strategy seeks to reach and sustain a competitive exchange rate (through macroeconomic policies and capital account regulation), and complement this with an incomes policy where wages grow in line with productivity, and a long-term balanced fiscal policy, but with space for counter-cyclical policy. Such strategy aims at a somehow stable balance between profits and wages by adopting a moderate wage policy, supplemented by a progressive tax reform that sacrifices mostly the rentier capitalists (Bresser-Pereira *et al* 2015).

[4] To the deviant position of Rossi (2014), see part 4.1

[5] According to Bresser-Pereira (2011, p. 113), new developmentalism "is a set of values, ideas, institutions, and economic policies through which, in the early twenty-first century, middle-income countries sought to catch up with developed countries".

Table 1. Developmentalist approaches in comparison

	Old developmentalism	**Social developmentalism**	**New developmentalism**
Aims	Productive change Industrialization with Import Substitution (ISI)	Productive change with intensive income redistribution Industrialization pushed by domestic market growth	Productive change with moderate income redistribution Re-industrialization
Targets	Increase of domestic market (consumption) Industrial production Balanced trade balance	Increase of domestic market (consumption) Industrial production Reduction in Gini index Balanced trade balance	Trade balance surplus (manufacturing net exports) Industrial production Moderate reduction in Gini index
Tools	Public investments (including state-owned enterprises) Active industrial policy and regional policies Trade protectionism Active fiscal policy Growth-cum-external debt Financing for development: public banks	Public investment Active industrial policies Moderate trade protectionism Industrial policies Wage policies (i.e. real increase in minimum wage) Social policies (income transfers) Active fiscal policies Financial development: public banks; consumer credit	Competitive exchange rate Capital account regulation Limiting external debt Industrial policy for export promotion Moderate trade liberalization Wage policy (real increase in of minimum wage along productivity) Long-term equilibrium with room for counter-cyclical policies Progressive tax reform

Source: Authors' elaboration

3. Currency hierarchy, limited policy space and economic policy strategies

3.1 A monetary perspective on structuralist theories and developmentalism: The concept of currency hierarchy

For a critical evaluation of these new developmentalist strategies, we seek to systematically assess the challenges and limits peripheral emerging economies face when choosing and designing economic policy strategies at the domestic level. Structuralist thinking traditionally has a strong focus on global asymmetries, expressed a as center-periphery relationship, and the need to overcome these. With the emphasis on 'external gaps'[6] and the 'Dutch disease', balance of payments constraints and their effects on

[6] The 'external financing gap' relates to the idea that due to a lack of domestic savings and finance, developing countries should import capital to be able to catch up (CITE).

macroeconomic dynamics play a major role. But usually the focus of this unequal center-periphery relationship and its impact on the external account lies on the real economy or on the factor endowment such as capital, while the monetary and financial dimension of this global center-periphery relationship has received little systematic attention.

International financial markets, especially under the conditions of financial globalization, are highly volatile and pro-cyclical, resulting in boom-bust cycles (i.e. Akyüz, and Cornford 1999; Ocampo 2001a) . The pro-cyclical nature of these markets is even more pronounced for peripheral economies, as global asymmetries are reflected in the fact that most countries, especially those at the periphery, are not able to borrow abroad in their own currency. As economic agents tend to concentrate international portfolios and markets in few major currencies – the dollar, euro, yen, pound, and Swiss franc –, and have limited appetite for adding additional currencies in their portfolios, the countries at the periphery have to run into foreign currency denominated debt. This is what Eichengreen and Hausmann (2005) label the 'original sin'.[7]

The higher the degree of original sin, the higher is the impact of boom-bust cycles in financial and growth volatility. The costs of financial volatility, especially of a volatile exchange rate, are high in terms of economic growth, as volatility leads to an underutilization of productive capacities and creates disincentives for investors, especially those facing the export market, due to large swings of the exchange rate along boom-bust cycles. That is how Eichengreen and Hausmann explain the strong negative correlation between the degree of original sin and income per capita, perpetuating global inequality.

Taking up this asymmetric pattern of the use of currencies, Cohen (1998, 2004) develops the concept of a 'currency pyramid' to classify the different types of currencies which should be distinguished according to their degree of monetary internationalization. The key currency, which has a privileged position, is placed at the top of the hierarchy because it has the highest degree of liquidity. The currencies issued by the other center countries (advanced economies) are in intermediate positions, and are also liquid currencies. At the opposite end are the currencies issued by peripheral economies, which are non-liquid currencies at the international level. These may be further differentiated by the aspect of internal use and acceptance of their domestic currencies. Those at the very bottom of the pyramid are characterized by the use of international key currencies even for domestic financial contracts, i.e. countries with a high degree of currency substitution ('dollarization'), while those usually denominated as 'emerging markets' and integrated into the global financial market rank a little above the bottom.

The structuralist conception of a world divided into two poles - center and periphery - and the existence of asymmetries in the world economy, have recently been applied by some Keynesian economists to the analysis of the international monetary system, taking into account Cohen's analysis (Andrade and Prates 2014, Paula *et al.* 2015). The currency hierarchy approach emphasizes the existence of a hierarchical and asymmetrical

[7] The existence of a center-periphery structure in the international monetary system is a historical reality beyond the peculiarities of the current state of financial globalization. As Flandreau and Sussmann (2005) show, international debt of Latin American countries, from the beginning of the creation of domestic currencies due to political independence, were confronted with the fact that even if bonds at the international market were denominated in their domestic currencies, they contained gold clauses, giving them the characteristics of foreign-exchange denominated debt.

arrangement in the international monetary system: currencies are hierarchically positioned according to their degree of liquidity, so that key currencies (U.S. dollar, Euro, etc.) have a high degree of liquidity (and lower premium risk) while peripheral currencies are non-liquids as they are incapable to performing the basic functions of money (medium of exchange, denomination of contracts and international reserve currency).

This monetary asymmetry is one of the basic asymmetries featuring the world economy and superimposed itself on the financial asymmetries, among which two stand out. Firstly, capital flows towards peripheral emerging economies depend on exogenous sources, which render these economies permanently vulnerable to their reversal by virtue of changes in the monetary conditions of the center countries (mainly, in the U.S.), as well as by the increase in the risk aversion of global investors. Using the words of Ocampo (2001) and Rey (2013), whereas the advanced economies are 'global financial cycle makers', peripheral emerging economies are 'global financial cycle takers'. Secondly, the disparity between the size of peripheral emerging economies currency and financial markets and the speculative pressures they face. Despite the residual nature of capital flows directed to these economies, their potentially destabilizing effects on their financial markets and exchange rates are significant, since the volume allocated by global investors is not marginal in relation to the size of these markets (Akyüz and Cornford 1999). In other words, this financial asymmetry stems from that fact that international financial integration is integration between 'unequal partners,' (Studart 2006).

It is exactly the mutually reinforcing monetary and financial asymmetries that underlie the aforementioned greater macroeconomic challenges faced by peripheral emerging economies in a context of free cross-border finance. On one hand, their currencies, placed at the bottom of the currency hierarchy, are particularly vulnerable to the inherent volatility of capital flows, ultimately determined by an exogenous process (the global financial cycle). Consequently, their exchange rates are more volatile. In turn, the greater exchange rate volatility has more harmful effects than in center economies exactly because peripheral emerging economies currencies are non-international ones, which increases the risk of financial fragility (due to the potential currency mismatches) as well as the pass-through of exchange rate changes to domestic prices. On other hand, they also result in different degrees of monetary policy autonomy in peripheral emerging economies and center economies. As Ocampo (2001, p. 10) points out: whereas the center has more policy autonomy and is thus "policy making" - certainly with significant variations among the different economies involved -, the periphery is essentially "policy taking". In other words, the monetary and financial asymmetries result in a macroeconomic asymmetry: the dilemma or impossible duality[8] is greater in peripheral emerging economies because their position in the international monetary and financial system strengthens the relationship between the policy rate and the nominal exchange rate and the influence of global investors' portfolio decisions on these key macroeconomic prices (Paula and Prates, 2015).

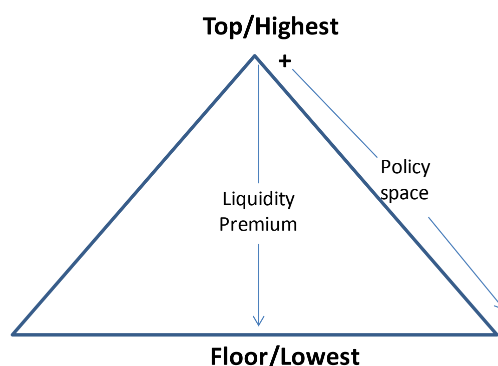
[8] According to Rey (2013, p. 21), within international financial integration, 'the "trilemma" [of monetary policy] morphs into a "dilemma" – independent monetary policies are possible if and only if the capital account is managed, directly or indirectly, regardless of the exchange-rate regime'.

3.2 Currency hierarchy and its limits for the policy space: The relevance of policy coordination

Currency hierarchy particularly is expressed in the countries´ different capacities for counter-cyclical policies and even for more active and sustainable growth-oriented policies which may allow an increase in productivity and equity. Countries whose currencies rank at the top of this hierarchy (or pyramid in Cohen´s terms) have a larger degree of freedom to undertake this kind of active macroeconomic policies (Figure 1). In contrast, when peripheral emerging countries engage in active monetary and fiscal policies to counteract economic shocks, they risk strong capital outflows, as global investors may engage in a 'flight into quality'. Ocampo (2013) calls this the problem of 'balance of payments dominance', in parallel to the mainstream concept of 'fiscal dominance'.

Peripheral emerging economies, from this perspective, suffer from multiple policy dilemmas, regarding the coordination of their macroeconomic policies (see Paula *et al.* 2015). In order to climb up, or at least not to further descend in the currency hierarchy, it is key to maintain monetary stability, as tolerating increasing inflation rates may cause direct capital outflows with destabilizing consequences. Yet, the orthodox receipt of increasing the interest rate makes domestic investment and growth dependent on capital inflows. This growth cum external debt may in the best case increase domestic investment. However, if not counteracted by a strict management of the exchange rate, it does cause an appreciation of the domestic currency, decreasing international competitiveness. This may turn the growth process depending on net exports with low technological content. In case this type of products, such as commodities, is not available or its prices decrease, growth turns unsustainable in the medium term. Amounting external vulnerability creates devaluation expectations and, at some moment, the reversal of capital flows which may cause a financial crisis in the peripheral economy, linked to currency and maturity mismatches, where the amplitude of the negative economic and social effects depends on the amount of net foreign currency-denominated debt.

Figure 1. Currency hierarchy and policy space



International monetary asymmetry under conditions of financial globalization constraints limits the use of more active monetary and fiscal policies for domestic purposes. On one hand, more volatile exchange rates of peripheral emerging economies requires frequent interventions by the central banks (the so-called 'fear of floating', e.g. Calvo and Reinhart

2002) which, in turn, reinforce the interaction between the exchange-rate and the policy rate, as domestic interest rates are used to curb exchange rate fluctuations. Consequently, the loss of monetary autonomy of peripheral emerging economies in a context of free capital mobility is greater than in developed economies. Furthermore, currency hierarchy requires high interest rates in peripheral emerging economies to compensate the greater liquidity premium in peripheral emerging economies (issuer of peripheral currencies) compared to center economies (issuer of key currencies).

On the other hand, fiscal policy frequently is managed in a pro-cyclical way, as the abrupt reversion of surges of capital inflows most caused by exogenous factors requires not only increases in the interest rates (to reduce capital outflows), but also fiscal tightening to compensate the negative effects of currency devaluation and high interest rates on fiscal balance as well as to inspire global investors confidence. Indeed, one of the consequences of capital account liberalization in a world of currency hierarchy is that 'fundamentals' of peripheral emerging economies are subject to the assessment of foreign investors and rating agencies. Under such conditions, continuing large budget deficit and public debt may led domestic and foreign financial markets to fear the deterioration in the economic fundamentals (inflation ratio, GDP growth, and the own fiscal stance) that can eventually lead to depreciation/inflation vicious cycles. Whether or not the concerns about budget deficits and public debt are well founded, the actions of financial markets cannot be shrugged off (Neville 2012). Consequently, fiscal policy may have to be modified to meet the fears of financial markets what can put a limit to the implementation of countercyclical policy in peripheral emerging economies.

From this perspective, the cushioning of boom-bust cycles turns an unavoidable, necessary element of any kind of growth-oriented policy strategies for peripheral emerging economies. Only then countries may gain policy space for changing their productive structure and pursuing inclusive policies. For this, the achievement and maintenance of a stable and competitive exchange rate turns to be necessary, even if not sufficient, to avoid an appreciation of the domestic currency beyond a level which allows at least for a balanced current account in order to prevent capital flows' boom-bust-cycles with subsequent financial crises and their damaging effects on employment and growth.

Yet, especially under the condition of financial openness, this is all but an easy task. On the one side, the policy of a fixed or managed exchange rate makes peripheral emerging economies highly vulnerable to speculative attacks. On the other side, for countries with foreign exchange-denominated debt, floating exchange rates have the potential to destabilize the domestic financial and productive sector, so that restricting financial openness by imposing capital account regulations seem to be the only way out (see Flassbeck 2001, Frenkel 2008, Rey 2013), even if their success is not guaranteed, depending on their context (Prates and Fritz 2015).

A competitive exchange rate certainly cannot be seen as sufficient to achieve multiple goals, as developmentalist strategies do. However, from the perspective of the limits imposed by this global currency hierarchy, is it a necessary one for laying the ground for sustained growth and inclusion. Thus, other policy aims, as relevant as they may be, should be designed in a manner to feed into this aim of a competitive exchange rate. In the best case, they may mutually support each other, shifting the issue of economic policy

coordination to the center of policy design. For instance, an industrial policy in peripheral emerging economies can only be successful if well-coordinated with macroeconomic policies.

Designing adequately coordinated policies is no easy task, and neither is the analytical assessment of the outcome of multiple policy goals under the necessary condition of a competitive exchange rate. For this endeavor, we methodologically disaggregate these strategies into three different layers: i) policy aims (i.e. productive change or income redistribution); ii) policy targets (i.e. industrial production or a reduction of the Gini index); and iii) policy tools (i.e. industrial or social policy). This methodological approach also is inspired by the Keynesian background of developmentalist thinking, which takes into account the complex interaction between economic structure, institutions, growth and distribution.[9]

4. Challenges and limits to increase policy space with redistribution

In this part we undertake a comparative analysis of the newly emerged developmentalist approaches, analyzing their macroeconomic consistency with regard to the policy limits imposed by the global currency hierarchy, and the impact on their aims for redistribution and structural change. The main limits of these approaches are summarized in Table 2 at the end of this section.

4.1. How neo-developmentalist approaches take into account the limits imposed by the global currency hierarchy

New developmentalism: some comments to the macroeconomic policy strategy

New developmentalism, as we have already seen in section 2.2., has a well-developed and coherent macroeconomic strategy as it aims precisely at integrating macroeconomics and development economics, applied "particularly to middle-income economies in which markets are already reasonably efficient in allocation economic resources in the competitive industries" (Bresser-Pereira *et al* 2015, p.10). The macroeconomic strategy should coordinate the key macroeconomic prices, in particular seeking a competitive exchange rate (close to 'industrial equilibrium rate'), low interest rate (to avoid attracting short-term capital flows) and long-term fiscal balance (to avoid an additional pressure on the currency appreciation and that the government become 'prisoner' of the rentier' interests). Therefore, the reduction of vulnerability to external shocks is the very core of this proposal. So it fully takes into account the limits for economic policies imposed to peripheral economies by the global currency hierarchy.

According to new developmentalism, one of the main macroeconomic problems in middle-income countries is the tendency towards the overvaluation of the exchange rate due to both Dutch disease and 'carry trade' capital flowsthat result from interest rate

[9] Some authors (Amado and Mollo 2015, Ferrari and Dutra 2014) seek to analyze and classify social-developmentalism as ´wage-led growth`, and new developmentalism as 'export-led growth', drawing here on the Kaleckian discussion of growth models from the perspective of functional distribution (Hein 2014). Yet, this systematization does not allow taking into account in a systematic manner external restrictions as the specific feature of peripheral emerging economies, which is key for our comparison. So we do not take up this classification in terms of growth regimes.

differentials. We doubt if Dutch disease is a general case to be applied to all peripheral emerging economies in all times. However, we sustain that such tendency realizes due to the own characteristics of the international insertion of peripheral emerging economies under the condition of a global currency hierarchy and financial globalization, resulting in two related trends: *high volatility of exchange rates* and *currency appreciation during the boom phases of international liquidity cycles*. Indeed, empirical works (Bluedorn *et al* 2013) show that in peripheral emerging economies capital inflows in general are higher than capital outflows and, consequently, net capital inflows tend to be greater and much more volatile compared to center economies. So regardless of a country suffering (or not) of Dutch disease, the movement of net capital flows to emerging economies - especially in recent years - seem to result in such trends.

A second comment to new developmentalism concerns the domestic interest rate. As already pointed out, the new developmentalist macroeconomic policy is based mostly on the binomial 'competitive exchange rate' and 'low interest rate'. However, greater importance has been given to the exchange rate. We sustain that the interest rate is also a key variable for an economic policy oriented towards economic growth and social inclusion for other reasons than just to reduce the interest rate differential.

Firstly, in a world of financial globalization with open financial accounts, the interdependence between interest rate and exchange rate has intensified given the use of interest rates to mitigate sudden capital outflows and their effects on the exchange rate. As we have already pointed out, a high interest rate is one of the factors that attract foreign capital and stimulate carry trade operations. Second, and not less important, the maintenance of a low interest rate is a sine qua non condition for the development of long-term financial relations in peripheral emerging economies because high interest rate stimulates agents' short-termist behavior (preference for short-term investments and/or highly liquid ones), which prevents the placement of longer maturity bonds, given the high risk premium that would be charged by investors. Thus, the short-term interest rate impacts on the formation of the term structure of interest rates, which connects short to long interest rates. Therefore, high short-term interest rate prevent the formation of a 'normal' long-term yield curve (that establishes the relationship between interest rates of different maturities), in which interest rates increase gradually in order to compensate the longer applications.

Therefore, high interest rates are one of the main factors inhibiting the formation of a private long-term securities market. Recent studies have highlighted that measures to stimulate the development of domestic financial markets, by diversifying sources of financing firms, can help to reduce the external vulnerability of a country, and in addition can strengthen traditional mechanisms of monetary policy transmission (wealth effect, credit channel etc.) which can make room for a reduction in interest rates. Greater access to domestic financing derived from the development of domestic bond market - by reducing dependence on external financing - can contribute to dwindling the mismatch between domestic and foreign currencies (Mohanty 2012).

A third brief comment is that the new developmentalism seems not to have an explicit policy to deal with the problem of inflation, which is a real concern of a group of emerging peripheral economies. 'Exchange rate populism' that lets (and even provides stimulus by high interest rates) the currency appreciated by market forces for price stabilization

purposes is criticized by this approach, but it is not clear what sort of economic policy should be implemented. For instance, it is not enlighten if an inflation targeting regime should be adopted or not, or if it is the case for a more flexible regime.

Social developmentalism: Negligence with macroeconomic consistency

As Carneiro (2012, p. 774) states, the reflections regarding the social-developmentalist approach are rather fragmented and academically less elaborated, gaining major inspiration by political debates and public policies. When analyzing the macroeconomic consistency of this approach, what becomes clear is that the potential links between income redistribution, mass consumption, investment, productivity gains, net exports and growth are well formulated. At the same time, the core of this literature, published in the Special Issue "*Economia, Sociedade e Desenvolvimento, 20 anos*" (Bielschowsky 2012; Carneiro 2012; and Bastos 2012), gives little to no attention to the formulation of fiscal, monetary and exchange rate policies, and their interdependence with the re-distributional and structural aims.

While Bielschowsky leaves these policy fields out of his analysis, when delineating the social-developmentalist approach, Bastos (p. 795ff.), from a political economy perspective, goes into a somehow more detailed analysis of fiscal policy, pointing to the multiple pressures on the public budget. He detects a tension between the request for social spending as a tool to spur domestic demand, and the request for investment, being it directly public, or incentives for private investment, to overcome structural bottlenecks in terms of infrastructure and spurring productivity. Fiscal austerity, thus, is rejected by him as a tool. Carneiro (p. 774ff.) mentions the relevance of rather low interest rates in order to foster investment, further supported by financial development for long-term financial contracts, and an enhanced access to credit for consumers, besides highlighting the importance of wage increases above productivity gains, in order to energize domestic mass consumption.

From these authors, only Bastos occasionally mentions the issue of exchange rate policies: within the debate on fiscal policies, he refers to a declaration of the then Brazilian minister of finance, Guido Mantega, where the minister rejects the option of a maxi-devaluation to achieve a competitive exchange rate, as this would sacrifice both social and public investment spending, thus undermining the growth strategy. Others like Amado and Mollo (2015, p. 83) argue, from the redistributive perspective, that the exchange rate should not suffer a strong devaluation, for two reasons: to facilitate the import of capital goods, allowing the national capital to absorb technological progress as well as to maintain wages earners' purchasing power, due to reduced domestic prices for tradable goods.

A more explicit proposal for macroeconomic policies of the social-developmentalist approach is formulated, to our knowledge, only by Rossi (2014), who explicitly addresses fiscal, monetary and exchange rate policies as part of an approach to achieve macroeconomic stabilization within social developmentalism. Departing from the macroeconomic regime applied in Brazil, the so-called *tripé* (a stool with three legs) of inflation targeting, flexible exchange rate and fiscal targets towards austerity, he argues that these may be formally maintained, yet re-interpreted in such a flexible manner that they are compatible with a developmentalist agenda. For this, he proposes to (i) include counter-cyclical policies into the fiscal target, making it more long-term; (ii) make the

inflation target one of various aims of monetary policy, and to accommodate supply shocks such as demand shocks stemming from wage increases or volatile commodity prices by a sufficiently flexible inflation target; (iii) pursue an active exchange rate policy. Here, he explicitly draws on Bresser-Pereira (2010) by arguing for a non-appreciated exchange rate to prevent Dutch disease effects; additionally this active exchange rate policy should curb volatility, resorting to capital account regulation (p. 206). So, regarding the exchange rate policy, Rossi presents for social developmentalism a proposal very similar to the concept of new developmentalism, and compatible, at least at first sight, with the perspective of a global currency hierarchy. At the same time, external constraints do not play a significant role in his analysis, listing it only as the last of 12 "historical features on which economic development depends" (p. 199). And astonishingly, he explicitly excludes wage policies from his analysis (p. 197).

So, four problems emerge here, from our perspective: first, re-filling rather clear cut orthodox policies such as inflation targeting with a rather heterodox content may cause major uncertainty among economic actors, as the multiple and diverse signals coming from this type of policies do not allow clear expectation formation.

Second, and more relevant, even this most elaborated proposal leaves a blind spot in a crucial aspect, by not considering the effects of wage increases above the productivity level, even if these are so crucial in this approach for the main growth channel via re-distributional demand shocks. With monetary policy compromised towards multiple goals, while increased demand for non-tradable goods may push inflation, and fiscal policy may be neutral in the best case (due for its room for fiscal counter-cyclical policies) there is no answer to be found how inflation stabilization can be achieved as part of macroeconomic stabilization. Together with the often declared fear of the negative redistributive effects of a devaluation, the position of this approach towards the exchange rate remains at least ambiguous, and with an implicit tendency towards tolerating an appreciated exchange rate, as it supports, at least in the short term, both inflation stabilization and purchasing power of wage earners. From this perspective, the short-term demand elasticity with regard to exchange rate changes seems to dominate the longer-term supply side elasticity of the exchange rate.

Third, in consequence of this rather hesitant posture towards a depreciation of the exchange rate, capital account regulation turns less effective, even if surely supported by all authors of this approach. First, as market expectations are formed along this line, it gets harder to make these measures efficient in their implementation, as it reduced the perceived exchange rate risk for international investors, thus creating an incentive for further capital inflows. Second, because there is then the risk that regulation is taken back when the risk of depreciation emerges (see also Prates/Fritz 2015).

Finally, it should be pointed out that the social-developmentalist approach gives long-term finance high priority, yet has a strong focus on domestic mechanisms linked to state-owned banks[10]. However, it is not clear how these mechanisms can be complemented by private finance, and how the government should stimulate them.

[10] On this particular concern, there a lot of contributions in Calixtre et al (2014).

4.2. Impact of macroeconomic policies on redistribution and structural change

New developmentalism

In the new developmentalist strategy, wages should grow in line with labor productivity, in order to maintain a balance between profits and wages that favors external competitiveness and a satisfactory industrial profit rate, understood as preconditions for a catch up strategy of peripheral emerging economies. Therefore, income redistribution has no functional role for growth, as it is the case of social developmentalism. Here, income distribution should not be faced directly by macroeconomic policy, but instead by progressive income taxation and the use of a minimum wage policy that protects low salaries.

According to the new developmentalist strategy, there is no conflict between domestic market development and export-led growth, as net exports increase employment, wages and, consequently, domestic consumption; in addition, they stimulate the primary demand variable, which is investment. The exchange rate is understood as a key macroeconomic variable, not only because a competitive rate contributes to net exports growth, but also to protect domestic market growth from predatory imports. So, the structural change should be driven by both the external and domestic market. This stimulus for the manufacturing sector is in line with the structuralist tradition, as this sector generates efficiency gains that result from static and dynamics economies of scale (the so-called Kaldor-Verdoorn effect that establishes a structural relationship between the growth rate of labor productivity and the growth rate of production).

In particular, according to new developmentalist strategy, a nation should adopt an export-led growth strategy for a short time, especially in situations where the current growth rate is unsatisfactory, i.e. it is below the rate needed to perform the catching-up. However, in a balanced growth situation, where the rate of investment and GDP growth are fairly satisfactory, a country does not need to choose between an export-led or wage-led strategy. What it needs is a balanced strategy in which wages grow at the same rate of productivity and the profit-wages ratio remains constant, so that the rate of profit in the long run remains at a satisfactory level to encourage the entrepreneur to invest (Bresser-Pereira *et al* 2015, ch 12).

One of the failures of new developmentalism is that there is no explicit policy related to financing, mostly long-term financing. Asian catch-up experiences show that financing is key for a developing strategy (Burlamaqui *et al* 2015; see also Gershenkron 1962, for an analysis of former late industrialization's experiences). For the new developmentalist strategy, financing issues seem be automatically 'solved' if a country is able to implement the 'correct prices' (exchange rate, interest rate, etc.). Since GDP growth is driven by net exports performance, according to the Keynesian idea that investment determines savings (and that the propensity to save from profits is greater than from wages) domestic savings are generated ex-post as a residual, due to the income multiplier process. Exchange rate devaluation produces two effects on aggregate savings: an increase in savings due to the growth of the investment rate, and a change in the composition of aggregate savings with the rise of the share of domestic savings vis-à-vis foreign ones. However, as Keynes (1937, 1939) has already stressed, *savings* and *financing* are different concepts: when the

entrepreneur decides to invest, what he/she needs is financing, not previous savings. The aggregate supply of financing is determined mainly by agents´ willingness of giving up liquidity and banks´ desire of creating actively loans and consequently new purchase power to investors. This calls for the discussion about what financial structure is more functional for development.

The 'dysfunctionality' of the financial system against the needs of economic development may have unfavorable consequences to the dynamics of the economy, mainly in the case of peripheral emerging economies. The usual conditions of operation of the financial system contribute to make this market systematically 'incomplete' and dysfunctional with respect to the financial needs of the economic development process, especially in the case of developing countries which still have underdeveloped financial markets. In case that the financial system is not well developed, planned investments may be financed by some combination of equity, short-term credit and, if available, foreign loans. Consequently, the (inadequate) structure for financing investment will be characterized by high degree of maturity and currency mismatches, and therefore by high risk (Hermann and Paula 2014). One cannot expect that such financial tools are created spontaneously by private financial markets, especially in the case of peripheral emerging economies. Catching-up experiences show the crucial role of the state in promoting by different ways (directly or indirectly) long-term financing tools to fund firms' investments.

Two final comments on the new developmentalist strategy. First, as we have seen, such strategy gives weight to export sector over domestic market in its development strategy, at least during the catching-up period. However, in countries – mainly in case of big/middle economies - where exports are a relatively small share of the economy – an export-led growth is hard to be implemented, as it would require a much more open economy and a low wage rate. This calls also a discussion if such strategy would be implemented in peripheral emerging countries with more consolidated democracy, due to the social demands from low-income segments of the population. Nevertheless, as we have pointed out in section 3, a good net exports performance have a key role both as a complementary source of growth and to reduce the external vulnerability, contributing for a better insertion of peripheral emerging economies in a hierarchical international monetary system. Second, although social policies and taxation policy are addressed by new developmentalist strategy, they seem to be integrated as an addendum. At least, in order to integrate such policies as an integral part of the developmental strategy, more analysis should be done on this concern.

Social developmentalism: Limits imposed by the tolerance for an appreciated exchange rate

The implicit tolerance for an appreciated exchange rate inhibits key mechanisms assumed in this approach. The idea that the structural balance of payments constraint would be mitigated both by export growth induced by the growth of scales and capabilities offered by the domestic market depends on the incentives for domestic investment. Yet, with an appreciated exchange rate, the stimulus to domestic consumption easily evaporates towards imported goods instead of creating new and diversified domestic production capacities. In this sense, the idea that "once wage increases are assured by internal

demand created by investment, there are no exogenous constraints preventing improvements in income distribution" (Amado and Mollo, 2015, p. 86) sounds rather naïve. The effective consequences on the productive structure depend on a series of variables such as the level and duration of currency appreciation, together with its volatility, the given productive structure and the terms of trade of traditional export products which may vary significantly between countries and over time. Without a competitive exchange rate that counter-balances the wage increases above productivity increases, investment and thus employment in labor-intensive sectors with high productivity may suffer a serious backlash, and in the worst case create incentives for a process of premature de-industrialization in a peripheral emerging economy (Frenkel 2008; Palma 2005).

Given an increase in imported goods, both for consumers and for autonomous investment, the equilibrium of the balance of payments thus depends on the availability of exportable commodities, in order to prevent an open balance of payments crisis, where the widened trade deficit would cause devaluation expectations, triggering massive capital outflows.

The impact of the increased domestic demand is thus channeled mainly into the non-tradable sector, and creates there bottlenecks which press for price level increases, as long as autonomous investment in infrastructure etc. does not come along. This may reinforce the pressure on the exchange rate to help sustaining price stability. With this, job creation, key to close the virtuous circle of demand-led growth, remains concentrated on the service sector, which traditionally offers labor contracts with lower quality.

This unbalanced growth of the non-tradable sector is magnified when domestic demand is further supported by monetized or 'commodified' social policies. This is the dominant new pattern of social policies in Latin America (see Fritz and Lavinas 2015). When services such as health and education are not provided as free public goods (or in insufficient quantity or quality), but in the form of monetary transfers, demand for non-tradables increases even more. A widened access for consumer credit, being it microcredit or other institutional arrangements which reduce the creditors' risk, goes in the same direction, and additionally may curb financial sustainability for households and financial institutions, depending on their growth path and conditions.

Table 2: The limits of social and new developmentalism

	Social-developmentalism	**New developmentalism**
Policy constraints due to currency hierarchy	Negligent: Ambiguity of exchange rate: reluctant to devaluate to protect real wages Rather expansive monetary and fiscal policies, wage increases → appreciated exchange rate for price stability Capital account regulation less efficient	Fully addressed
Redistribution	Link from domestic market growth to net exports to jobs interrupted by overvaluation	Not functional, but included as additional aspect; core of the concept is exchange rate policy
Structural change	Tendency of overvaluation → industrial policies less effective → re-commodification	Competitive ER necessary but not sufficient
Financing of development	Fully addressed, but limited role for private financing	Not directly addressed

5. Concluding remarks

Our comparative analysis of recent developmentalist strategies from the perspective of the limits imposed by the global currency hierarchy shows that both approaches presented here have their merits, and their limits. The new developmentalist approach, on the one hand, has a clear definition of a virtuous circle launched by setting strategically macroeconomic prices. A devaluated exchange rate is seen as key to increase net exports and create incentives for investment in higher technology sectors. Thus, it has a clear focus on shielding the economy from macroeconomic volatility, which fully responds to the requirements for peripheral emerging economies imposed by the asymmetric global monetary system. Yet, with its strong focus on the exchange rate, this approach gives less attention to interest rate policy, leaving an empty space for questions regarding the financing for development, and the conduction of inflation stabilization policies. In general, strategic impulses, including competitive exchange rate, financial and industrial policies, remain restricted to the export sector. Yet it is questionable if in all cases these may be sufficient to stimulate the domestic market and to achieve sustainable growth and inclusion into the labor market. From this perspective, both impulses for finance and for technological upgrade should not be limited to export sectors, as foreseen in this strategy. Regarding redistribution, new developmentalism basically trusts on employment creation via net exports, while wages should only grow along with productivity gains. Progressive fiscal and social policies appear to be more an addendum, with little attention given to the potential interaction between macroeconomic and social policies.

The social developmentalist strategy, on the other hand, makes redistribution the center piece of its definition of a virtuous growth cycle. A jump in terms of domestic mass consumption is expected to push investment in the industrial sector, and also to increase net exports over time. The temporary worsening of the current account due to increased imports of capital and other goods is expected to be bridged by commodity exports. Yet, the macroeconomic counterpart, especially regarding exchange rate policies and macroeconomic consistency, has received little attention in this approach. Proposing wage increases above the productivity level and preoccupied with maintain wage earners' purchasing power, this approach is resistant to exchange rate devaluations, and targets the monetary policy to foster domestic financing for investment and consumption. As there is no clear answer to the question on how to maintain price stability in this setting at the same time, we conclude that there is an implicit inclination to use an appreciated exchange rate. With this, there is an immanent risk that the supposed growth cycle is interrupted, as the injected additional demand for consumer goods leaks towards imports, restricting the dynamics of the domestic market to the main non-tradable sector, the service sector. As a result, structural change results to be truncated, with a premature dominance of this sector, which also limits the process of redistribution. The appreciation of the exchange rate, together with the worsening of the current account, foster exactly the pattern of boom-bust cycles led by instable international capital flows and volatile commodity prices, which perpetuate the status of a peripheral economy and further limits its space to pursue active economic and social policies oriented towards sustained growth with productive diversification and equity.

From this perspective, it remains clear that it is no easy task to successfully combine developmentalist policies aimed at reducing volatility with major economic inclusion and structural change of production patterns. Such a strategy certainly must give priority for a stable and competitive exchange rate, which should embrace the regulation of international capital flows, as the new developmentalist strategy formulates. But this might be enriched by high efforts to foster domestic financial development, in order to effectively reduce reliance to foreign currency finance. With the macroeconomic prices set right, industrial policies should address both exports and the domestic sector, to push for a broad modernization process.

This does not mean that redistributive goal and social policies have no role in this strategy. Even if fiscal policies are limited in some way by the need to maintain equilibrium over the cycle, giving room to counter-cyclical policies, positive interdependencies between macroeconomic and social policies have to be explored. Instead of seeing social policies as an additional cost, they should be made part and parcel of policies to reduce macroeconomic volatility. This is true, for example, for a progressive tax system with a strong weight for income taxes, which automatically go down in crisis periods, thus maintaining part of domestic demand during downturns, and reducing them in upturns. A broader coverage and level of unemployment insurance works in the same manner, as do policies to maintain employment in crises, distributing the losses of work time reduction among workers, employers, and the state. These interdependencies between macroeconomic and social policies to curb the cycle deserve further research.

At the same time, it remains clear that this kind of developmental strategy is all but easy. It does not only depend on the constellation of forces at the domestic level which allow for

profound reforms of the tax system, to make this more fair and more compatible with an approach envisaging macroeconomic stabilization. It also depends on the availability and will of center economies to tolerate export surpluses of peripheral emerging economies, in order to leave them space to climb up the currency hierarchy.

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