Structuralist Development Macroeconomics and New Developmentalism

Laporde, 2012

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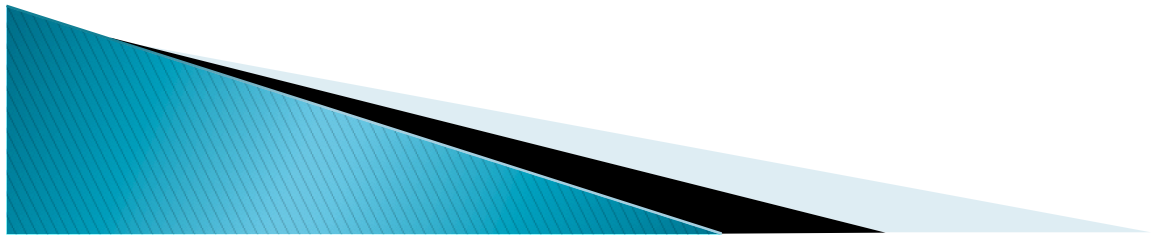
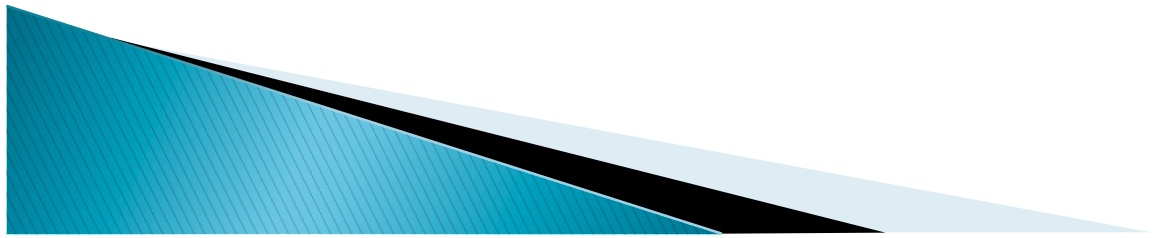
1. INTRODUCTION



Structuralist Development Economics

- Was the dominant view on economic development from the 1940s to the 1960s
- Its main authors were Rosenstein-Ronda, Ragnar Nurkse, Gunnar Myrdal, Raúl Prebisch, Celso Furtado, Hans Singer, Arthur Lewis and Albert Hirschman
- Its main sources were the classical political economy, particularly Marx, and Keynesian and Kaleckian macroeconomics



Its method was historical-deductive (not hypothetical-deductive)

and its ideology, nationalist.

It supposed, historically, that, to develop and catching up, countries need

- Form a developmental state, led by a class coalition formed by a national bourgeoisie, a state bureaucracy and the working class.
- Adopt a nationalist ideology and a developmentalist strategy
- Make a national (nationalist) revolution and industrial revolution, i.e., a capitalist or bourgeois revolution

Main theses of structuralist development economics

- Economic development requires industrialization, because

a) value added per capita is higher in the manufacturing industry;

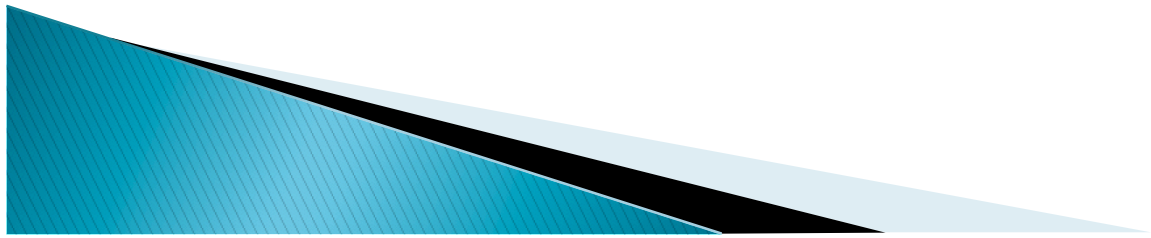
b) tendency to deterioration terms of trade

- National-developmentalist strategy:

a) planning by the state

b) forced savings and state investment

c) foreign savings (due to “foreign constraint”)

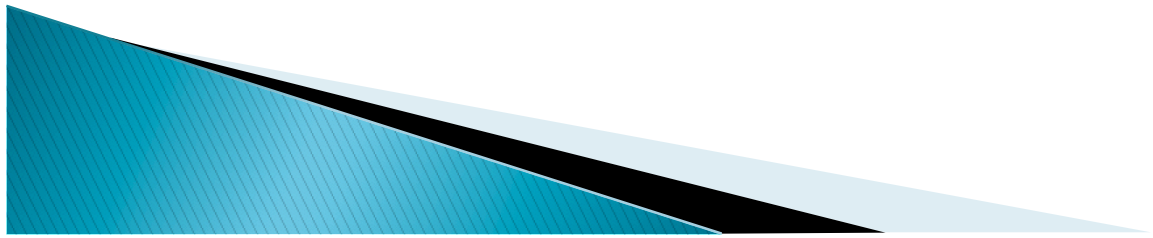


Structuralist development economics (and Keynesian economics) were

expelled from the “mainstream” in the 1970s

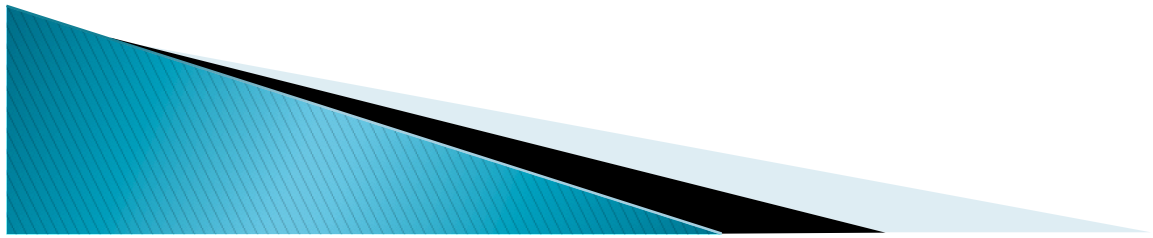
Because a relatively minor crisis in the United States, in the 1970s, open room for:

- The replacement of Fordism by the neoliberal class coalition
- Justified “scientifically” by neoclassical economics.

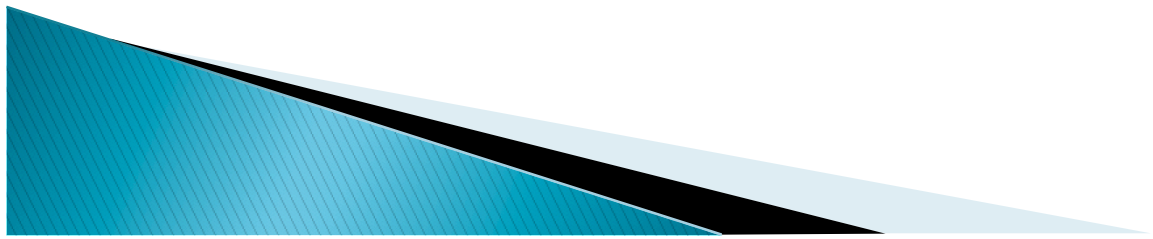


Meantime,

- In Latin America, the bourgeois revolution was discredited by “dependency theory” (that Cepal adopted turning irrelevant)
- While, worldwide, structuralist development economics ceased to produce new knowledge



- 2. DEMAND PUSH, INVESTMENT LED GROWTH



30 years later, in the early 2000s, a renewal beggins

as it became increasingly clear that the neoliberal (Washington) consensus and neoclassical economics failed in causing growth, stability, while increased inequality.

A new moment or a new opportunity appears for the renewal and hegemony of developmentalism.

Landmarks:

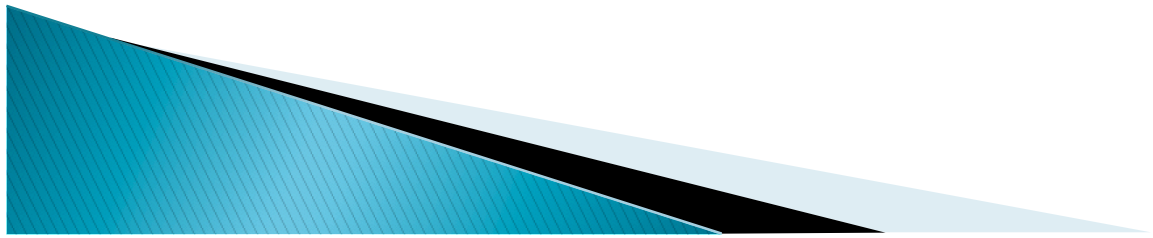
Unctad and 1997 Asian Crisis (Jan Kregel, Asian Crisis 1998)

Laporde and "Kicking away the ladder" (Ha-Joon (2001/2)

"New developmentalism" (Bresser 2003/2006)

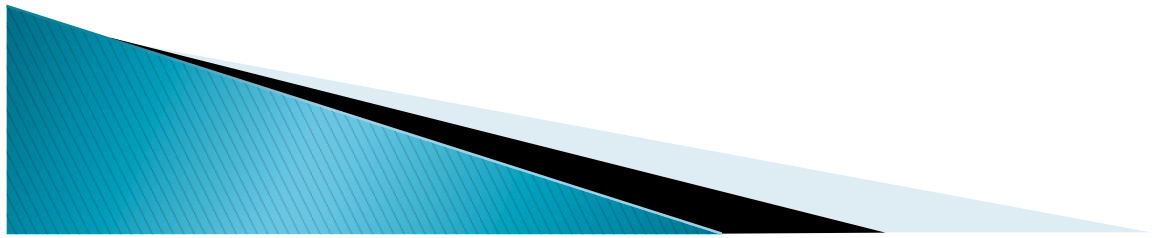
Structuralist development macroeconomics (Bresser and "Globalization and Competition", 2009).

"Ten Theses on New Developentalism (80 original subscribers 2010)



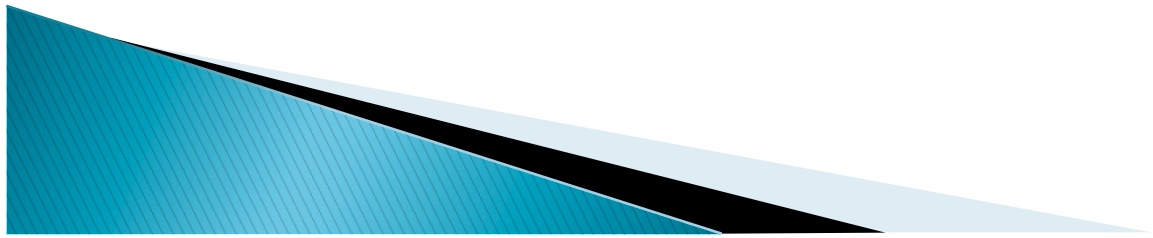
What a well managed economic system is supposed to do (objectives)

- 1. Economic development
- (that depends on investment with technical progress embodied)
- 2. Price stability
  (that depends on Demand = Supply, etc.)
- 3. Financial stability
  (limited borrowing on national money in relation to the capital of banks + more limited borrowing in foreign money)t
- Or
- Full employment
- (that depends on ivestment)



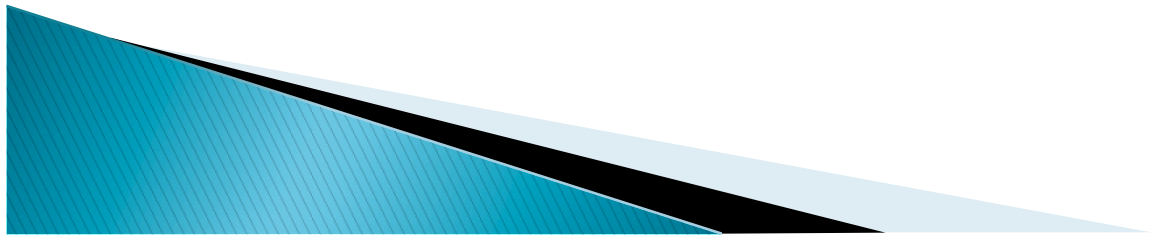
Investment depends on

- Existence of profit expectations (profit opportunities) of entrepreneurs compared with the cost of capital.
- That depends on efficiency of each business enterprise and of
- a) domestic demand (wages)
- b) foreign demand (world economy cycle) and
- c) access to foreign demand (exchange rate)



Thus, economic development is

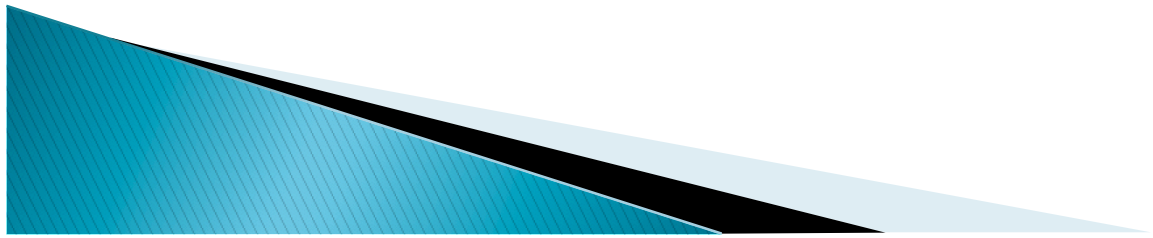
- Profit pushed (“satisfactory rate of profit)
- Domestic demand pushed (wages and salaries)
- Foreign demand pushed (global cycle)
- Access to foreign demand pushed (competitive, “industrial”, exchange rate).



And is caused by investment

with embodiment of technical progress that increases the productivity

- a) of labor (by producing goods and services that have higher value added p.c., that require people with higher education, that require higher wages and salaries (to remunerate the increased value of such labor)
- b) of capital (machines more efficient than labor and in relation to previous ones).

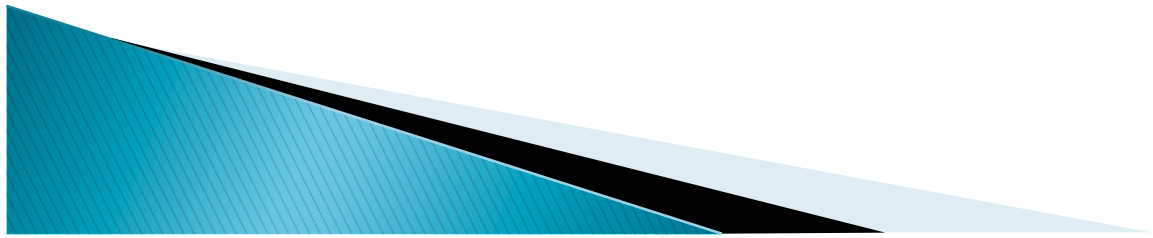


But, and the supply side?

- It is in the “efficiency of business enterprises” above (growth requires efficient or low cost business enteprises).

–that depends on education, supply of competent business entrepreneurs, good institutions, etc.

- Historically, these variables are not bottlenecks to growth.

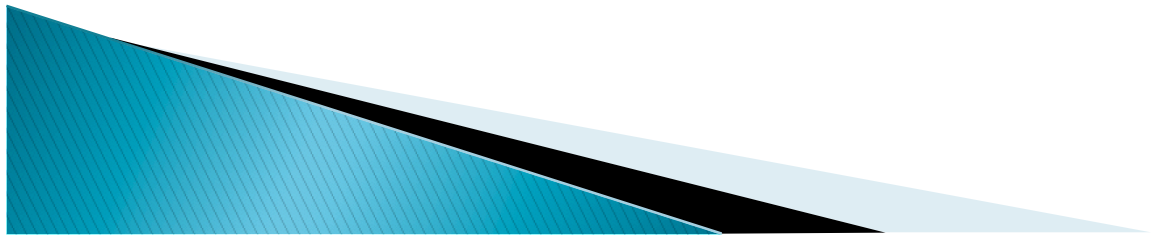


But, where are savings?

-They also do not represent a bottleneck when the economy is monetary and entrepreneurs have access to credit.

- And, where are innovations?

-They are “creation of demand” and, so, of profit opportunities for individual business enterprises.



And the debate wage-led x export led?

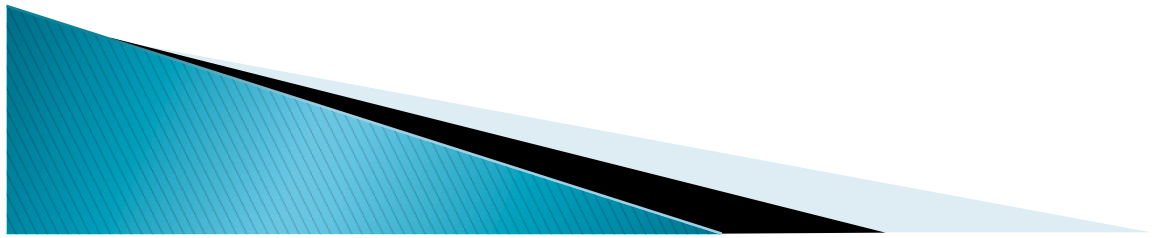
- It is better to say, “investment led growth”.
- Demand depends as well of wages and of exports.
- In short periods it may depend principally
- A) on the increase of wages (if profits are too high), or
- B) on the increase of exports, if the objective is
- to increase the “level growth”, not just to maintain it.

Two structural tendencies limiting demand,

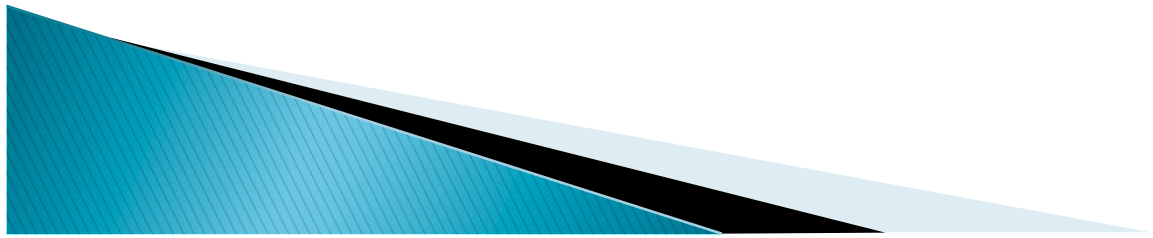
besides the Keynesian “chronic insufficiency” or critique of Say’s law (in a monetary economy, there is the possibility of hoarding).

1. The tendency of wages to grow below the productivity rate
   - limiting demand in the domestic market
   - caused by unlimited supply of labor

2. The tendency to the overvaluation of the exchange rate
   - limiting access to foreign markets.



- 3. THE EXCHANGE RATE AND GROWTH

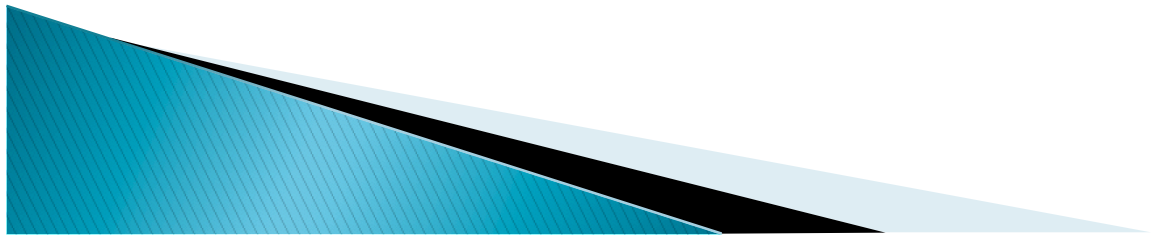


The exchange rate is the more strategic macroeconomic price

It affects:

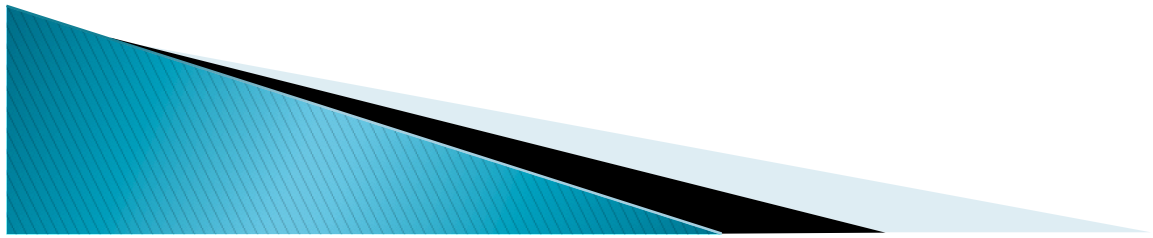
- Imports
- Exports
- Real Wages
- Savings
- Investment
- Inflation

Associated key variables: investment, profit opportunities, economic nationalism (cultural), national development strategy (institutional)



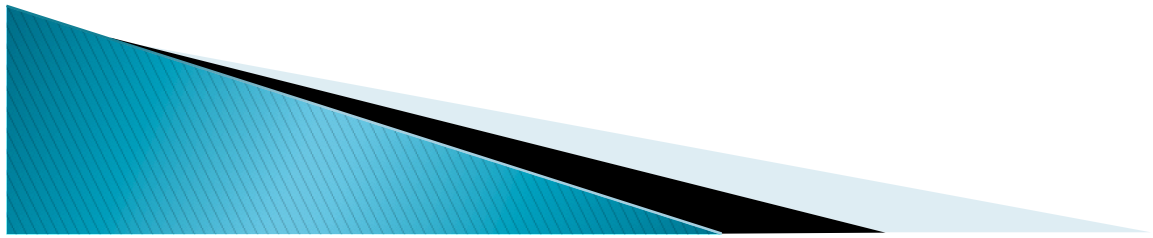
Yet, the exchange rate is a "forbidden" variable in the North

- Because the North countries knows how strategic it is
- Because they have extra difficulty in managing it because have reserve money
- Because an overvalued exchange rate in developing countries in good for them:
- -they export more
- -developing countries need their loans and their direct investment
- -favor higher profit outflows in their money



The metaphor explaining the role of the exchange rate in growth

- It is a “light switch”.
- When it is overvalued it switches off the state of the art manufacturing industry firms of developing countries from global demand, and switches in less efficient foreign firms to their domestic markets.



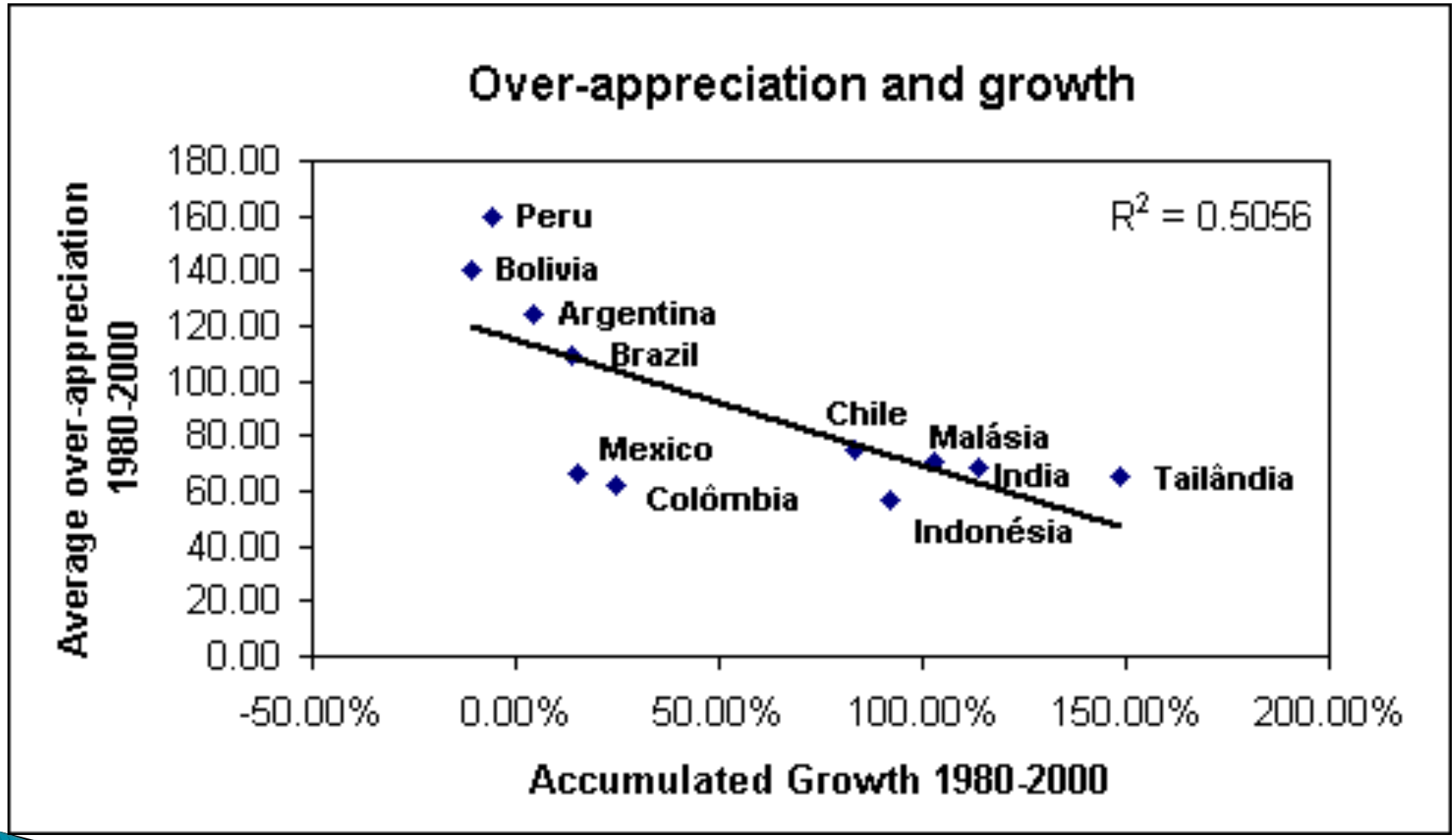
Overvaluation of the exchange rate in developing countries

- It is a cyclical and chronic problem, caused by

A) The Dutch disease (that is present in most developing countries)

B) The structural tendency to the profit and the exchange rate be more higher in developing countries – what attracts capitals.

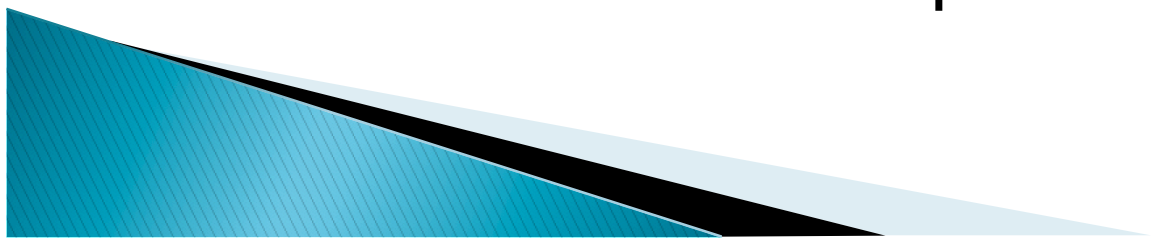
C) Current policies: a) attract capitals to solve the “foreing constraint”, b) anchor to inflation; c) exchange rate populism.


Over-appreciation and growth
Average over-appreciation 1980-2000
180.00
160.00
140.00
120.00
100.00
80.00
60.00
40.00
20.00
0.00
-50.00%
0.00%
50.00%
100.00%
150.00%
200.00%
Accumulated Growth 1980-2000
R2 = 0.5056
Peru
Bolivia
Argentina
Brazil
Chile
Malásia
Mexico
India
Tailândia
Colômbia
Indonésia

But what is the equilibrium exchange rate?

- It is not the “current” equilibrium exchange rate (the one that intertemporally balances the current or trade account).
- It is the “industrial” equilibrium (the one that makes competitive business firms using technology in the state of the art.

The exchange rate in developing countries is often below the current and almost always below the industrial equilibrium.



Thus, the exchange rate, that was absent from development economics

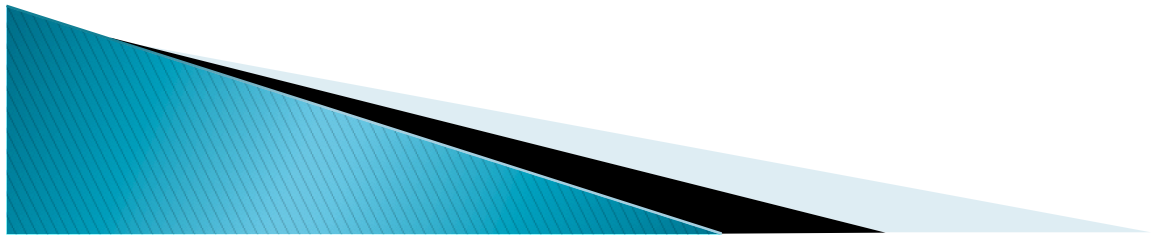
becomes central to it.

Conventional, Keynesian and structuralist economists assumed that disequilibrium of the exchange rate was short term problem, were mere “misalignments”, consequence of “volatility”.

In the moment that a group of models and empirical research shows that it is chronic or a long term problem, consequence of tendency to the cyclical overvaluation of the exchange rate, it turns into a core development economics (macroeconomics) problem.

How conventional economists argue against exchange rate policy

1. The call “mercantilists” who tries to manage it (ideological argument that I will not discuss)
2. They say that is impossible to manage the exchange rate in the long run (ridiculous)
3. They try to change the agenda to the fix x floating regimes.
4. They argue with the triangle of impossibilities.



3. The “fix or float” divide is misleading

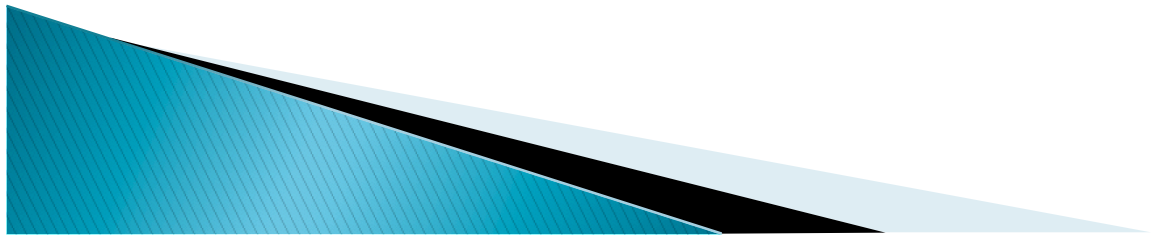
Developing countries are supposed to manage the exchange rate,

because the exchange rate in developing

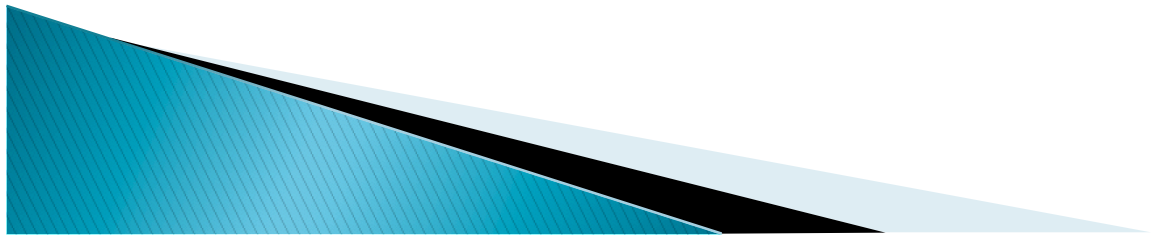
- 1. do not float sweetly around the current equilibrium as conventional economists say
- 2. nor are just highly volatile as Keynesians say
- But
- 3. has the tendency to overvaluation that is “solved” by a balance of payment crisis.

The triangle of impossibilities is misleading

- First, because countries do not need to choose sharply between monetary policy, exchange rate policy and capital mobility.
- Second, because, if they have to choose, the variable that should be sacrificed is not exchange rate policy but capital mobility.

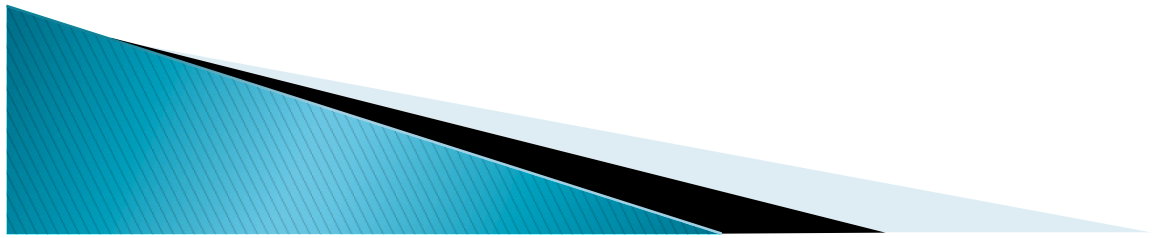


4. THE DUTCH DISEASE OR NATURAL RESOURCES CURSE



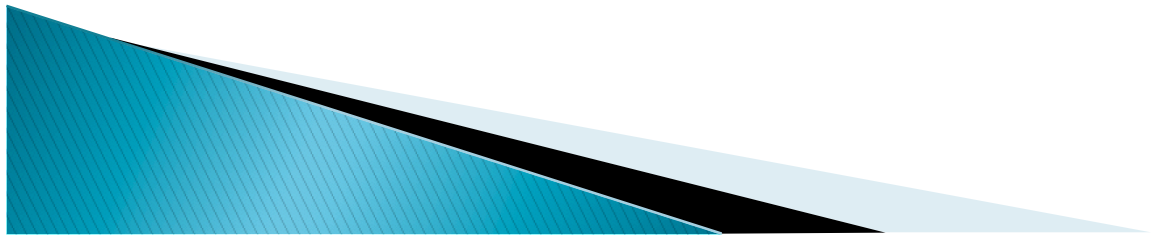
Concept

- The Dutch disease or natural resources' curse is the chronic over-appreciation of the currency caused by the fact that the derives Ricardian rents of exploring abundant and cheap resources whose production is consistent with an exchange rate substantially more appreciated than the exchange rate necessary to make economically viable industries using technology in the state of the art.



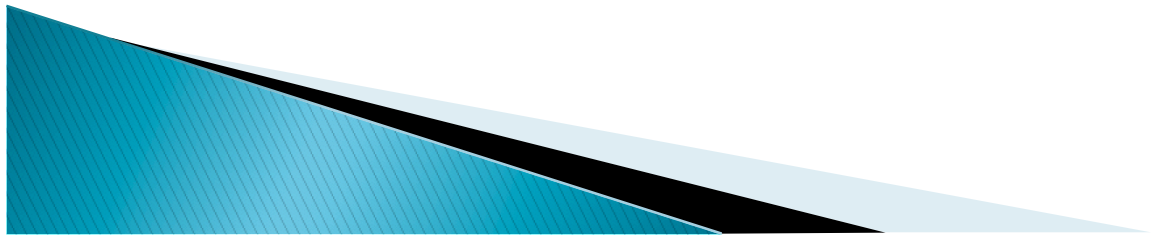
Market Failure

- The Dutch disease is a major market failure because it turns not viable industries using technology in the state of the art.
- Given the fact it is consistent with current account equilibrium: the market does not correct such failure even in the long term.
- Also a market failure because the commodity industry that originates it causes a negative externality over the other tradable industries.



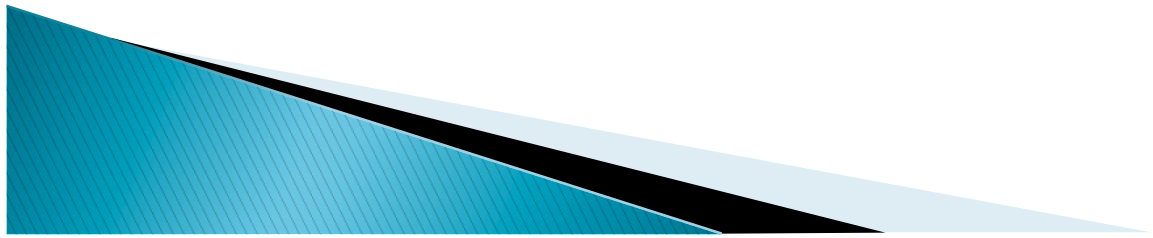
Ricardian rents

- The Dutch disease originates from Ricardian rents appropriated by the country.
- When it is not neutralized, rents are appropriated by all consumers in the form of lower prices than the ones that would prevail if tradable goods were produced in the country using technology in the state of the art.



Demand side obstacle

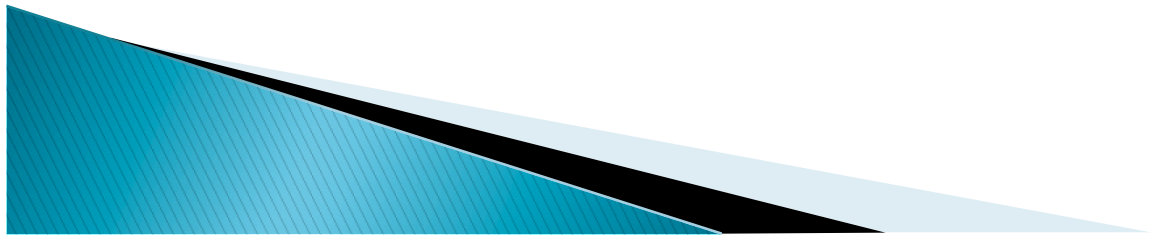
- The Dutch disease is a demand side obstacle to growth as it disconnects (denies access of) competent tradable industries from global demand.



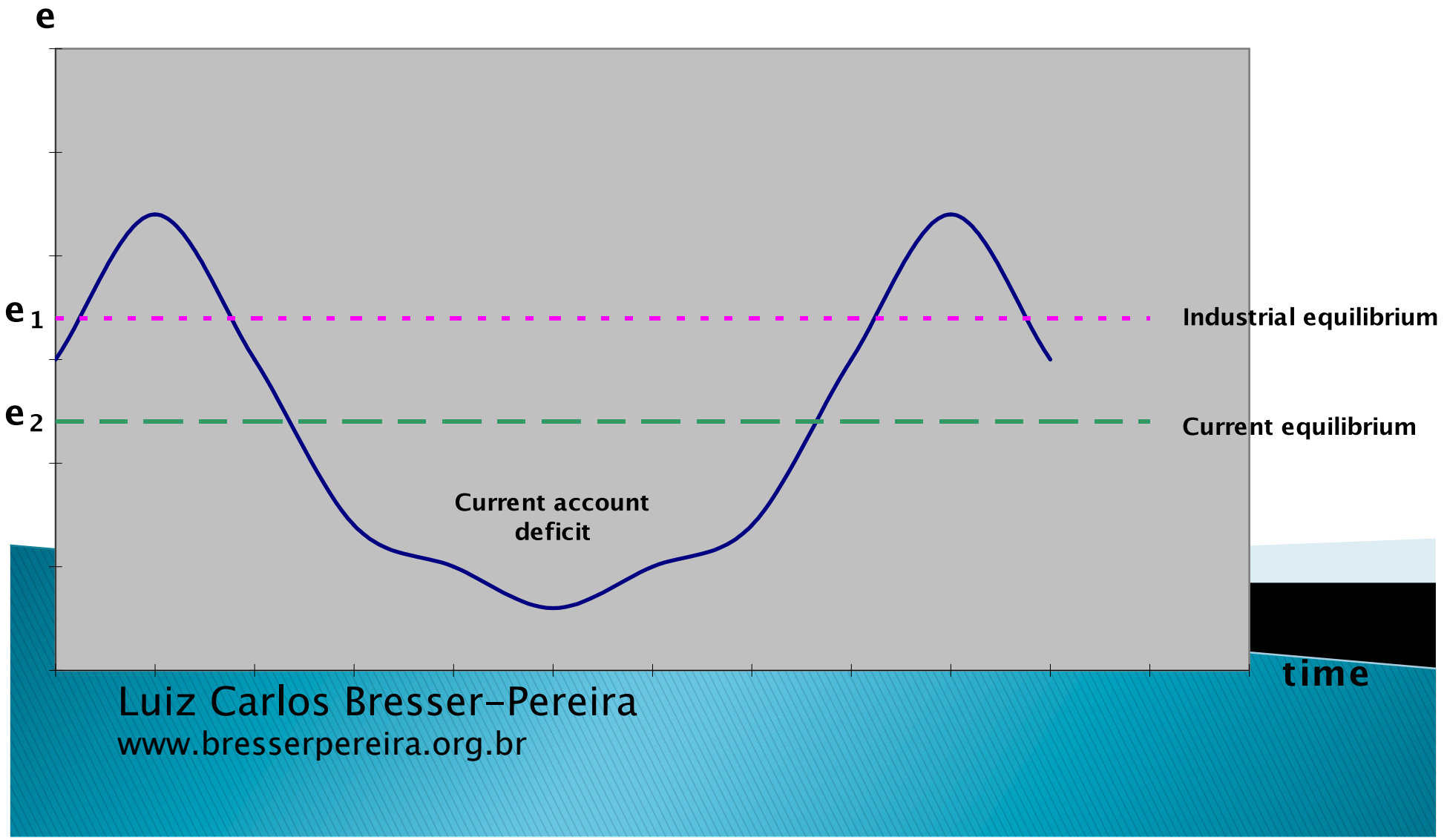
Two equilibrium exchange rates

- When the Dutch disease is present we have to exchange rate equilibriums:

- "Current" (or market) exchange rate equilibrium
  - ϵ_c
- "Industrial" exchange rate equilibrium
  - ϵ_i

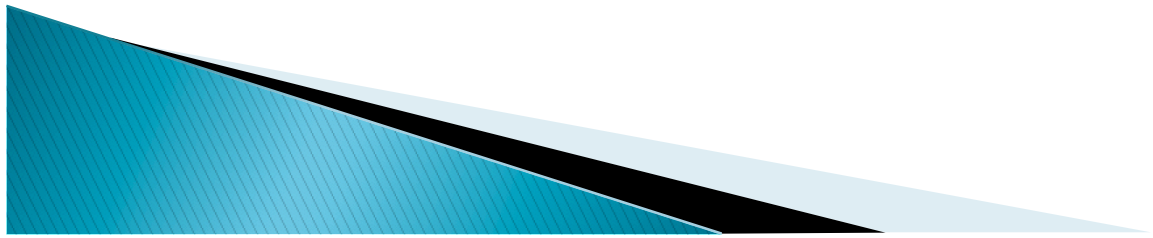


DH-Equilíbrio Corrente e Industrial



Doublely effective exchange rate

- Note that I am speaking of an effective exchange rate: one that is based on a currency basket (effective) and that considers tariffs and subsidies (effective-effective)



Dutch disease and the two equilibriums

- No Dutch disease
  - $\epsilon_c = \epsilon_i$
- Dutch disease
  - $\epsilon_c < \epsilon_i$

Two prices

- Market price

Corresponds to the current equilibrium exchange rate

$p_m :: \epsilon_c$

- Necessary price

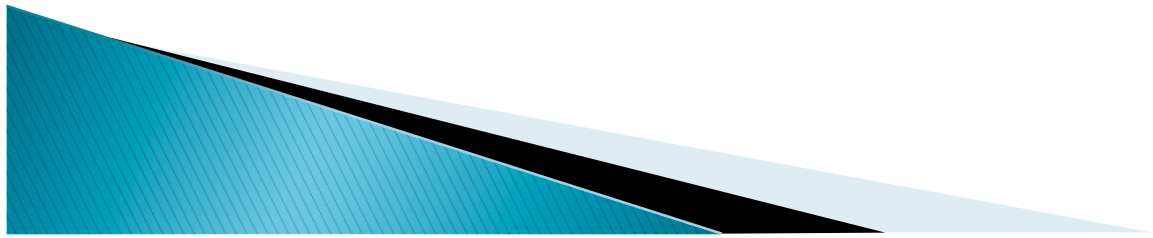
Corresponds to the industrial equilibrium exchage rate

$p_n :: \epsilon_i$

*Necessary to make equal both rates

Dutch diesease intensity

- Depends on the size of the Ricardian rents, which depend on cost of production in relation to the less efficient producer (that supposedly determines the price).
- More practically, on the relative difference between the market and the necessary price for each tradable industry:
- $dh = [1 - (pm_z / pn_z)] * 100$
- -where z represents the several tradable industries except the one originating the disease.



Dutch disease's change of intensity

- because production costs change
- or because international prices increase

Example:

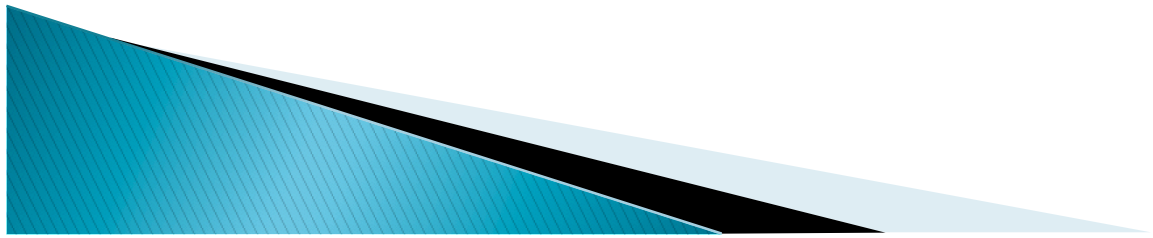
If in a oil producing country the average market price is 40 and the necessary price is 100, the Dutch disease intensity will be 60%.

If the oil prices increase 100%, the exchange rate will evaluate correspondingly, the average market price will go to 20, and the Dutch disease intensity rises do 80%.

Symptoms of the Dutch disease

- In poor countries: No industrialization in countries exploring natural resources.

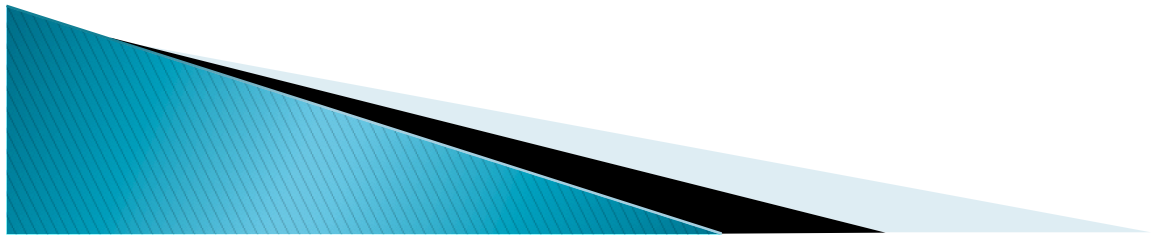
- In middle income countries: Desindustrialization or “maquilization”
- (1) because prices increase, or (2) because “neutralization” is abandoned in name of trade liberalization.



Technological intensity of the commodity originating the disease

- Although growth usually involves transference of man power to more productive industries, except in the "amplified concept" of the disease
- The originating commodity does may well be technological intensive.

(The oil, or the agrobusiness industries are increasingly sophisticated)



Damage?

One can argue that since commodities that originate the disease have high per capita value added, it would not damage the economy.

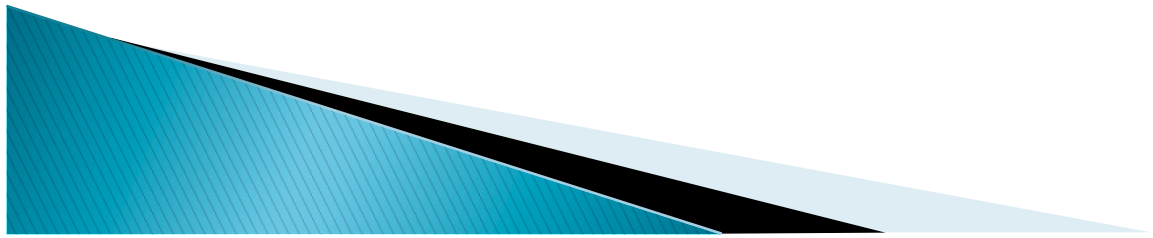
- This will one true if:

  1. did not exist industries presently or potentially with higher value added;

  2. the exporting industry plus non-tradable ones are able to guarantee full employment.

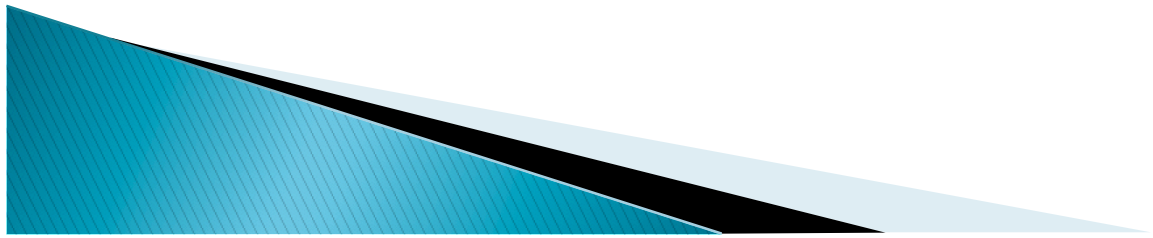
Amplified concept

- Cheap labor is also origin of Dutch disease provided that the wage span (difference between engineers' salaries and workers' wages) is substantially higher than in high wage (rich) countries.
- In this case, the exchange rate will be determined by the goods using cheaper labor, and the more sophisticated industries will turn economically unviable.

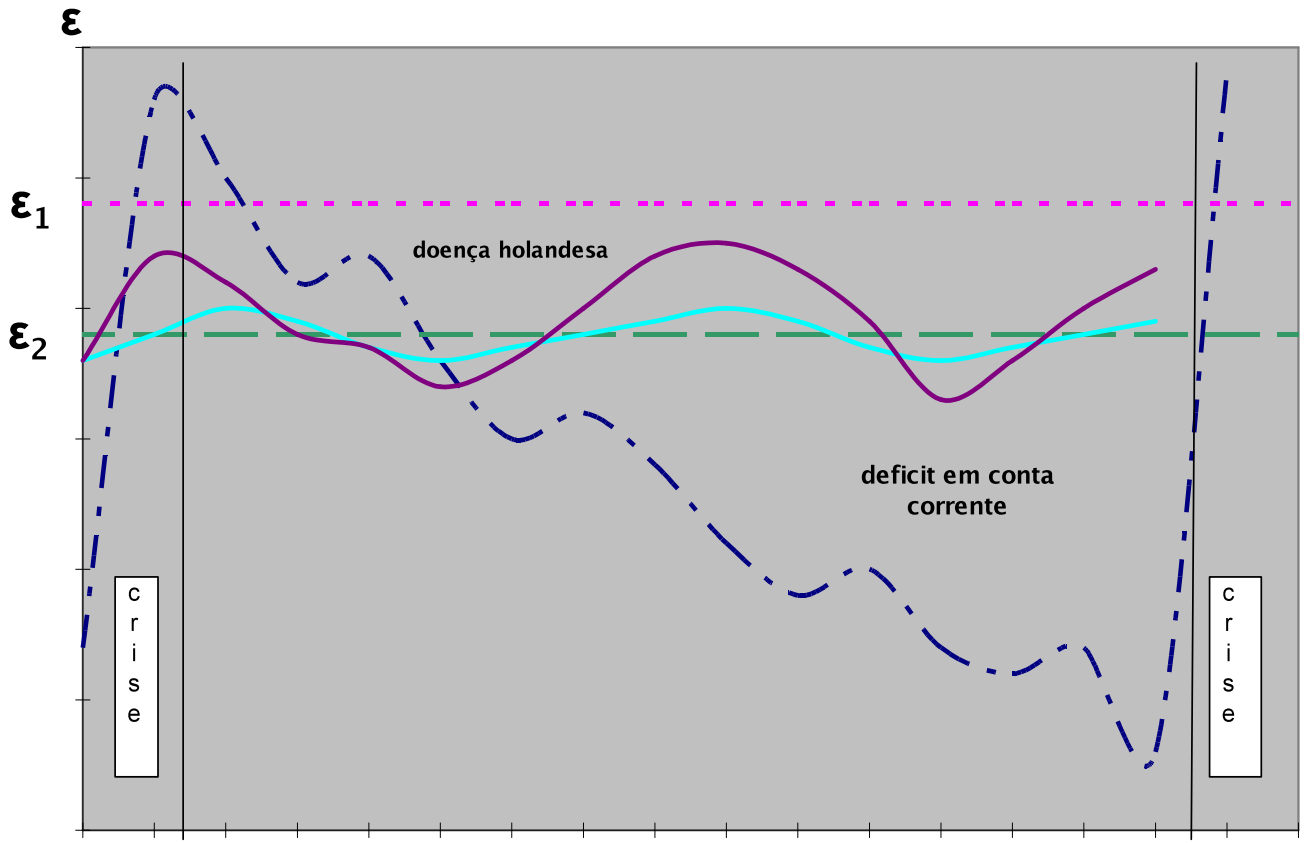


Neutralization

- A tax on sales and exports that move up the supply curve of the commodity to the level where tradable industries' average market price will be equal to the the necessary price.
- Establishment of a international fund to avoid currency appreciation.
- Possible creation of a stabilization fund for the commodities originating the disease.



Tendência à sobreapreciação cíclica da taxa de câmbio



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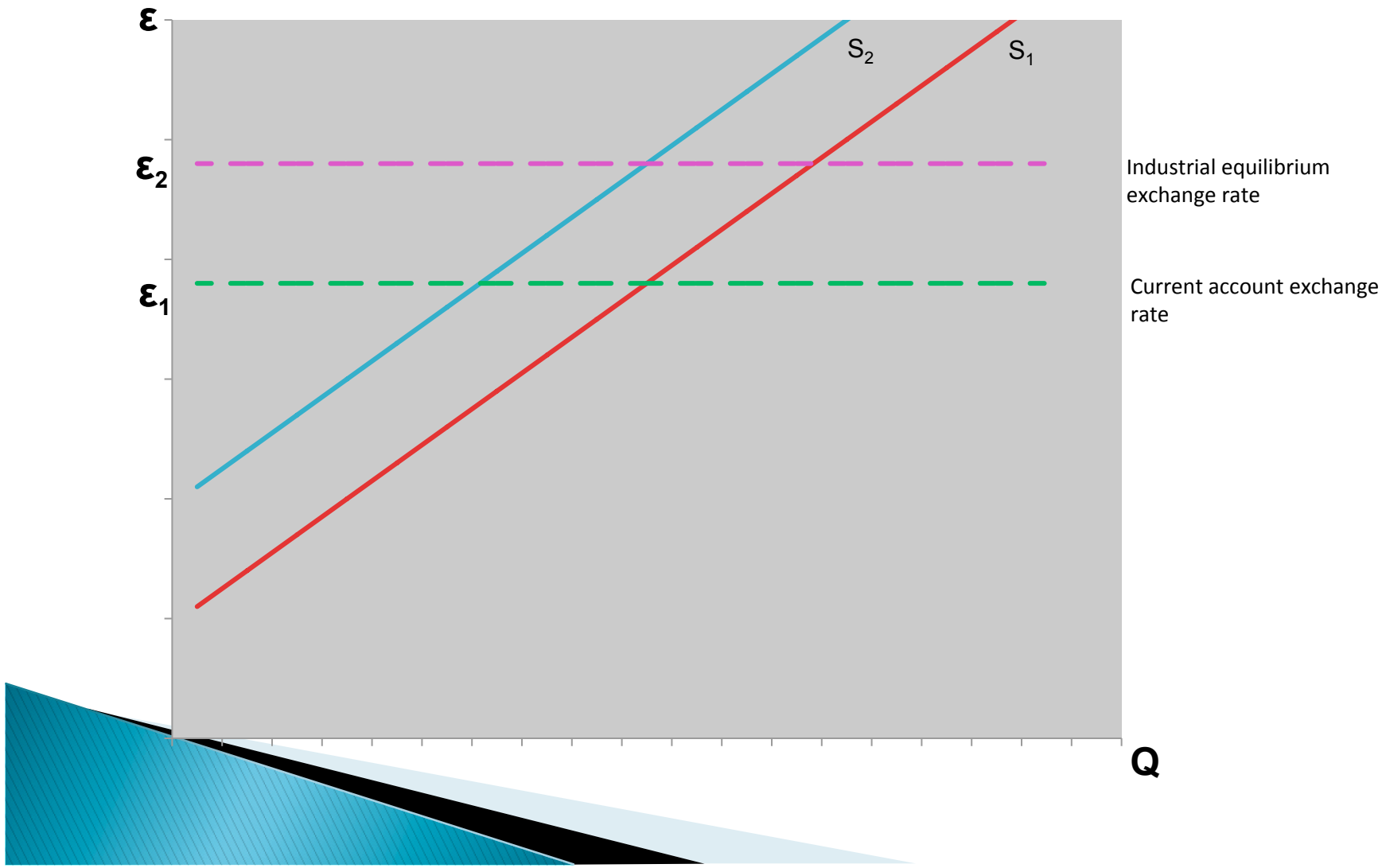
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Current account exchange rate
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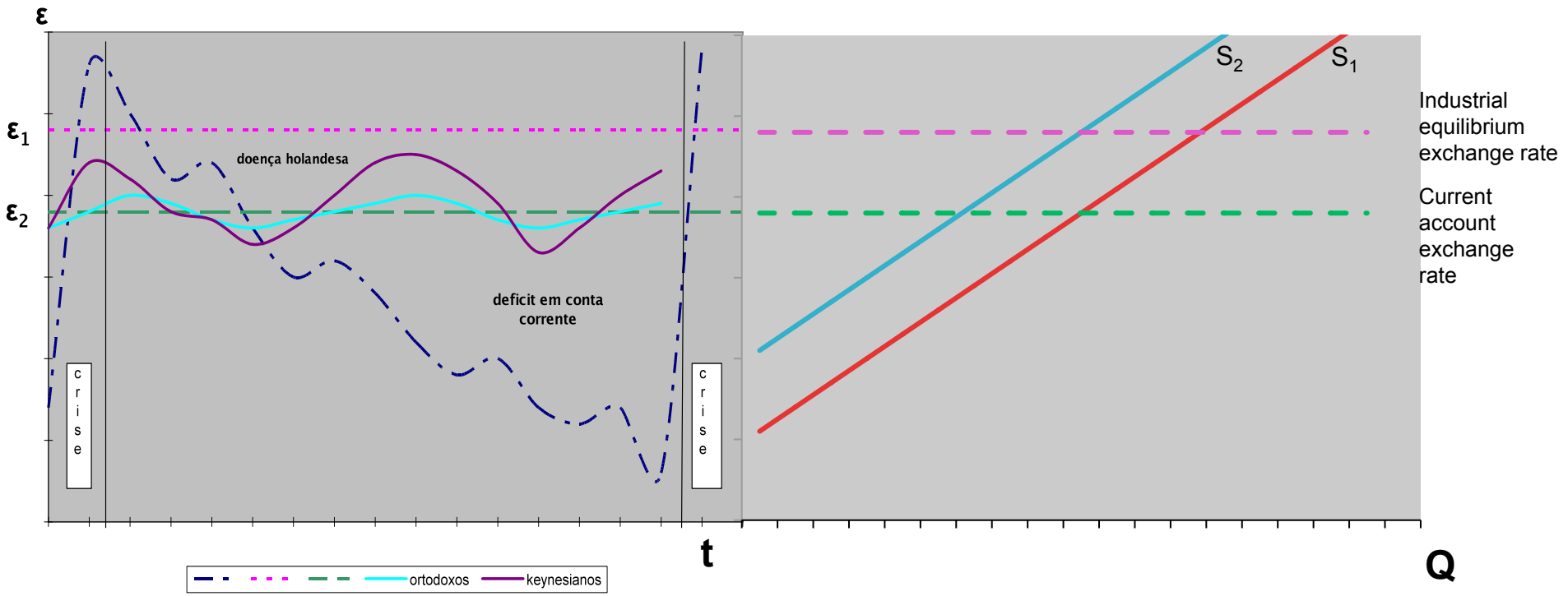
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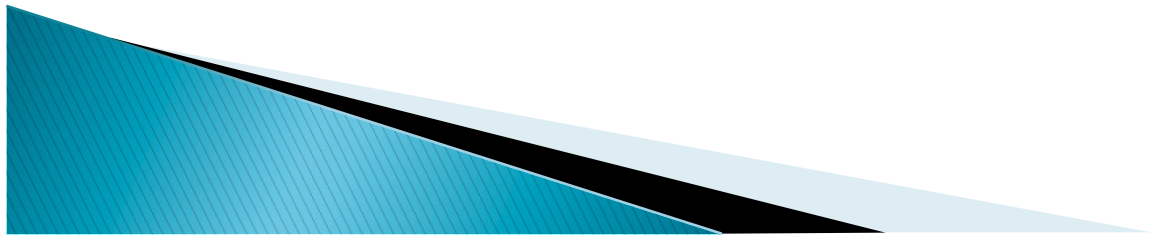
Industrial equilibrium exchange rate
Current account exchange rate
Q

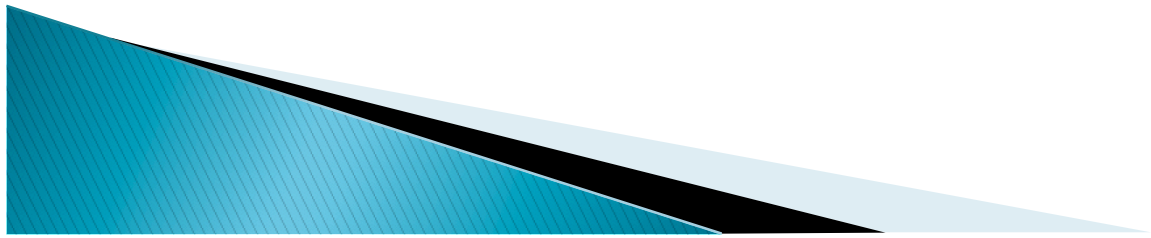
The tax

- Should capture the rent, leaving some margin for the commodity exporters.
- Should be variable, depending principally on the changes in international prices.
- Should be ‘marginal’, not reducing exporters profits.



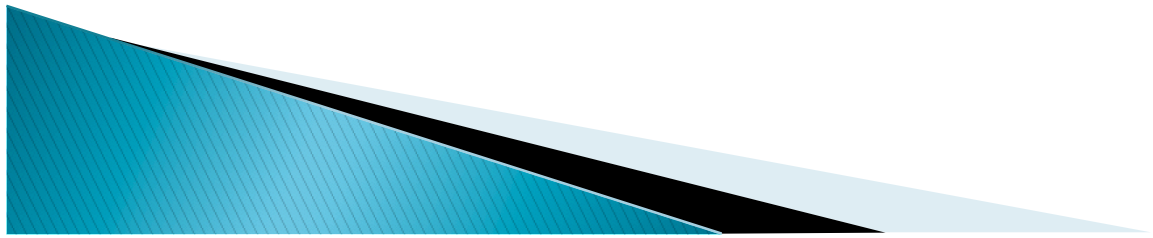
The tax rate

- A tax rate, m, should be equal to the Dutch disease's intensity, m, divided by the relation between the current and the industrial equilibrium exchange rate:
- $m = dh / [e_c / e_i]$
- If, as in the previous example, $m=0.6$ e e_c / e_i é igual a 0.40, o imposto deverá ser de 150%.



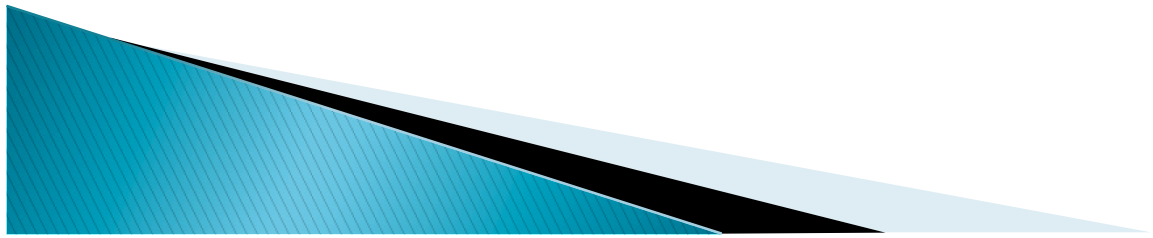
Uses of the tax: three stages

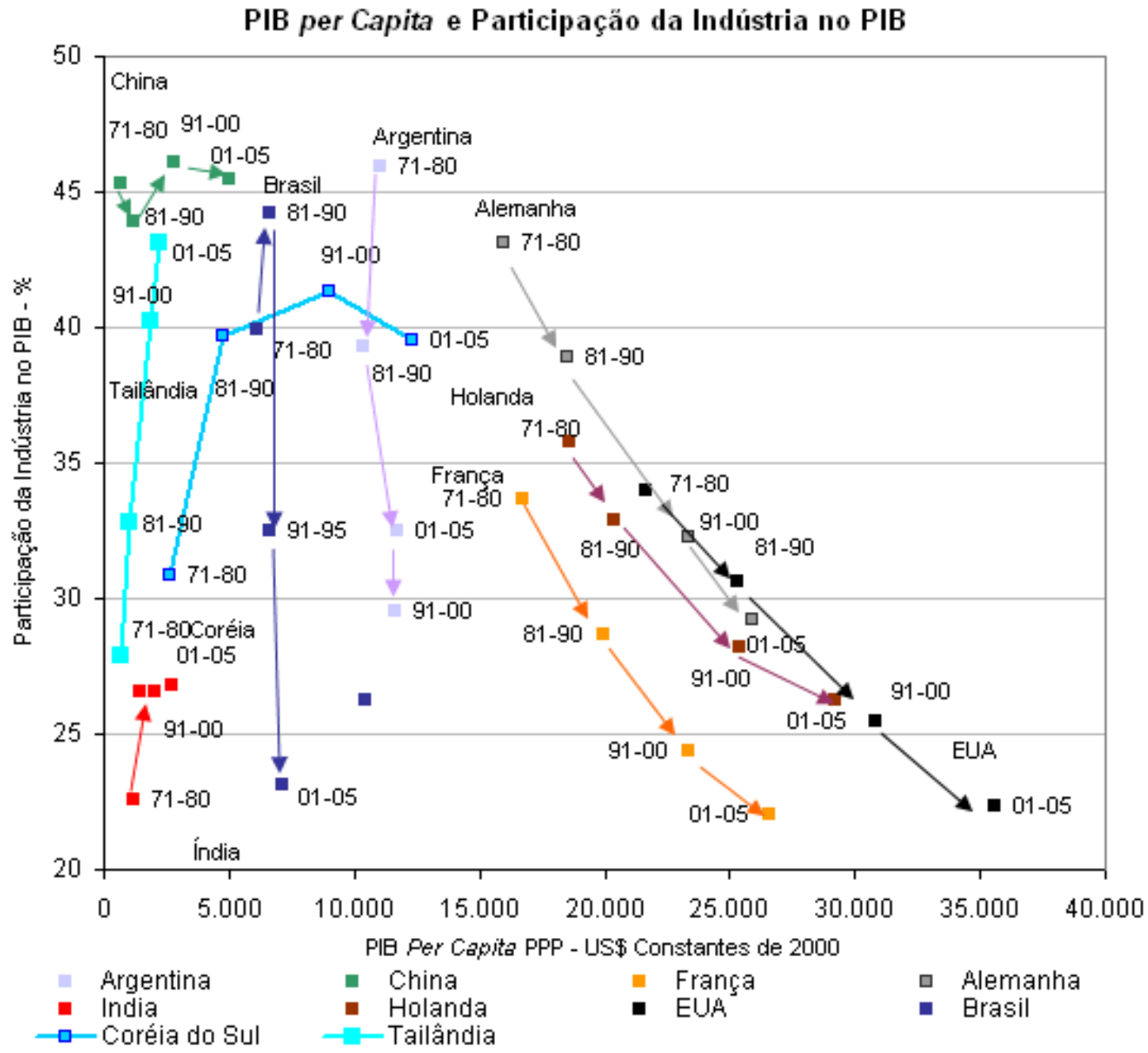
- Poor country: tax is used to finance infra-structure;
- Middle income country: tax is used to create a stabilization fund
- Rich country (Norway): tax is used to create international fund.



Difficulties in neutralizing

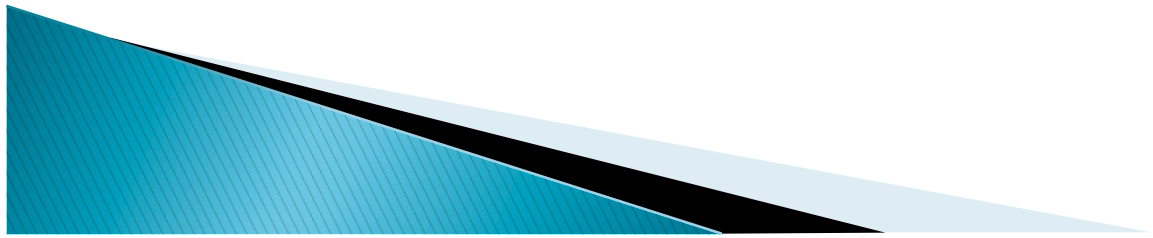
- Economic: transitory rise of inflation
- Political 1: wage reduction
- Political 2: exporters' fear that the tax is not just marginal.





Fonte: Banco Mundial.

- **5. Critique of the "foreign constraint-foreign savings" conundrum**



The foreign constraint-foreign savings compound

- Foreign constraint: poor countries lack dollars, explained by the two gap model and Thirwall law.

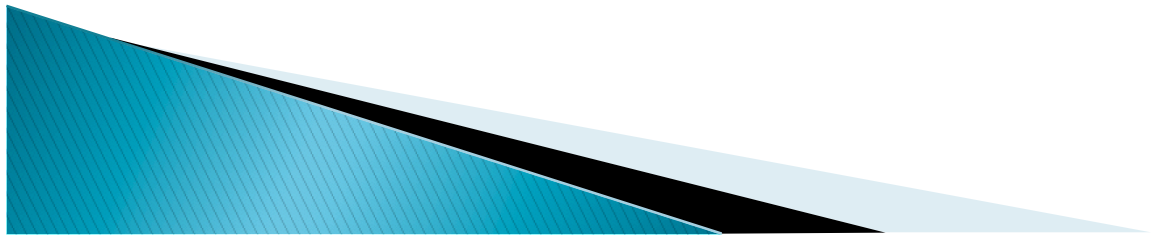
a) Two gap: their income-elasticity of its imports of manufactured goods is higher than the foreign income-elasticity of their exports of commodities. Thus they face a "two gap" problem (lack of savings and of dollars).

b) Thirwall law: limits growth to export growth.

- The "cure" to both problems are foreign savings (current account deficit) financed by foreign loans and foreign direct investment.

There is no foreign constraint, just overvalued exchange rate

- Many developing countries export manufactures. But even for commodity exporters the exchange rate in the current equilibrium is enough.
- The Thirwall law is obviously correct, but it does express foreign constraint, but export constraint that also disappears once the exchange rate turns competitive.
- Nurkse: “capital is made at home”.

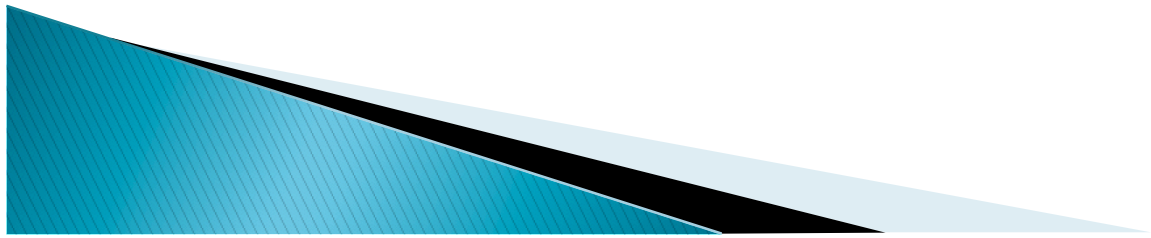


Yet, foreign savings policy is firmly recommended by the North, and

and softly accepted by the South

Because they would solve the foreign constraint, and they would be added to domestic savings increasing the investment rate.

Actually, rather than being added do domestic savings they replace them. The rate of substitution of foreign for domestic savings is usually high.



Nevertheless, in the early 1990s

- GFSP became a mantra for the Washington consensus
- The say “capital rich countries are supposed to transfer their capitals to capital poor countries” was an assumption above discussion.
- In Brazil, elites continue to believe that direct investments are “good” for the country.

Historical evidence does not support these views

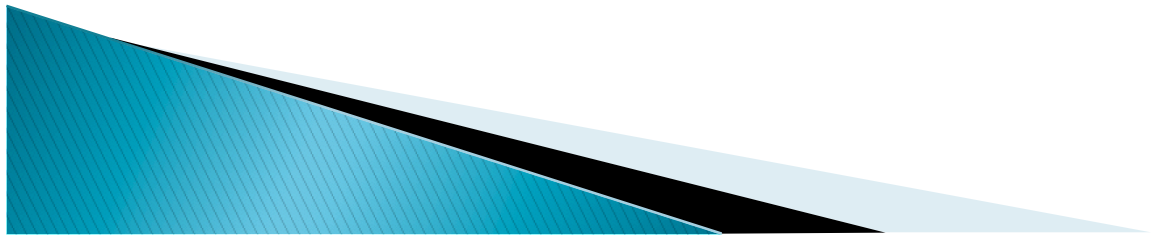
- All countries always developed using essentially domestic savings
- Developing countries tend to face negative capital outflows
- We cannot find correlation between foreign savings (current account deficits) and growth
- We also cannot find correlation between FDI and growth
- The Feldstein-Horioka “puzzle” also did not support the GFSP: investment is financed by domestic savings

In Brazil, in the 1990s…

- Full belief in the GFSP
- Foreign savings increased from around zero in 1994 to almost 5% of GDP in 1999
- Yet, the investment rate did not increase
- Why?
- In a 2002 paper with Nakano, “Economic growth with foreign savings” we first developed the model; it became completed in the paper 2007 paper with Gala, “Why foreign savings fail to cause growth”, or “Foreign savings, insufficiency of demand and low growth” (JPKE, 2008)

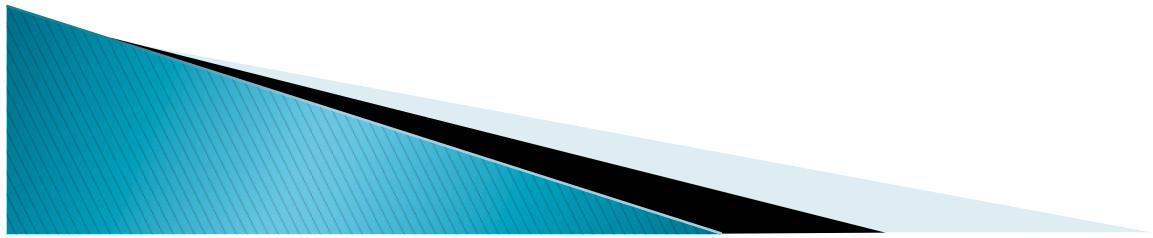
Departing point

- When a country has a current account deficit, the exchange rate that equilibrates this is more appreciated than the exchange rate that equilibrates intertemporally a zero current account deficit.



Detrimental in three inverted stages

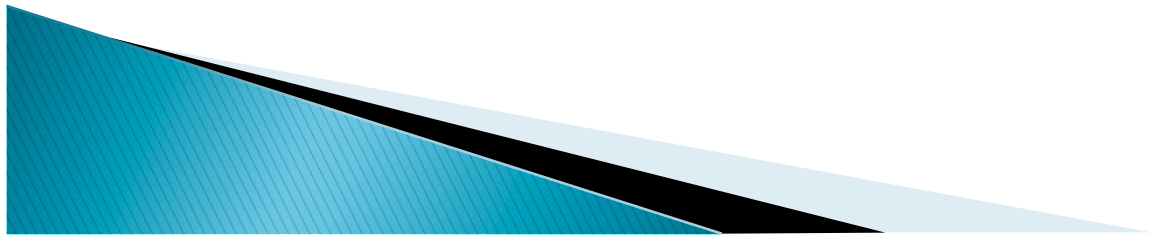
- GFSP is detrimental to economic growth in three inverted stages:
- – in the last, because causes balance of payment crisis (obvious)
- – in the middle stage, because it causes financial fragility and “confidence building”
- – before that, because it usually involves a high rate of substitution of foreign for domestic savings



Two major types of financial crises

- Banking crisis (typical of rich countries)

- Balance of payment crises (typical of developing countries),
  - whose immediate cause is foreign creditors' loss of confidence and the suspension of the rolling over of commercial and long term debts.

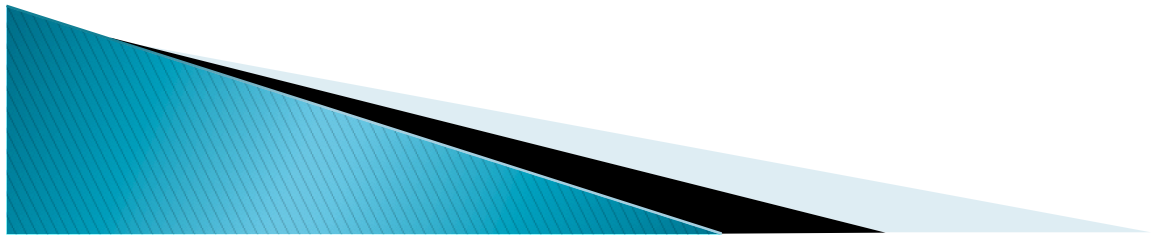


Foreign savings and rate of substitution of foreign for domestic savings

- $Sx = X - M +$ net profits sent abroad
  $=$ current account deficit
- $I = S = Sx + Si$

- Rate of substitution of foreign for domestic savings

$$dSi/dSx$$

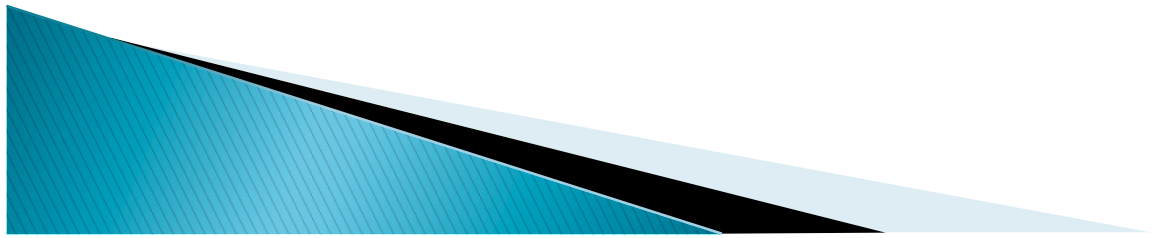


Why dSi/dSx tends to be higher (above 50%)

- Because, when there is current account deficit, the exchange rate, e, appreciates.

-The e that balances a current account deficit of 3% is more appreciated than the one that balances a zero current account.

-The appreciation depends on the elasticity of e to the variation of the current account.



When e appreciates foreign substitute for domestic savings, because

on the supply side,

-the more appreciated e, the higher w (wages)

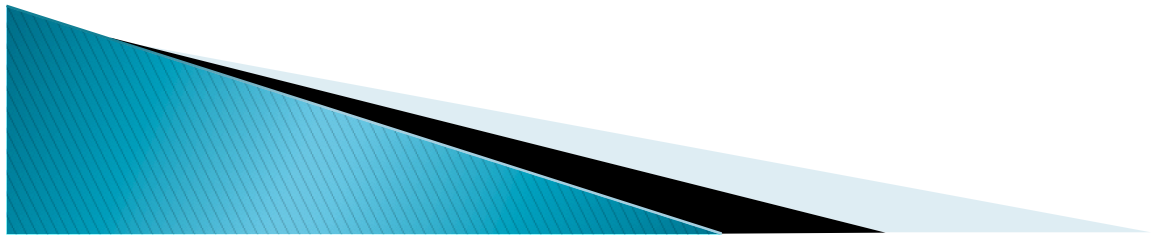
-the higher w, the higher consumption, the smaller domestic savings

on the income side,

the more appreciated e, the smaller the expected rate of profit on export investments - the smaller domestic investments (and savings)

On what depends dSi/dSx

- On the elasticity of wages and salaries to changes in e (the higher one, the higher the other)
- On the marginal tendency to consume (the higher one, the higher the other)



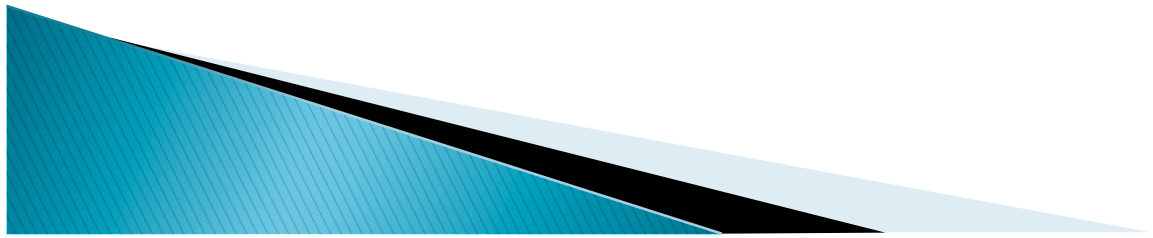
How the marginal tendency to consume varies

- It varies from country to country depending on level of growth:

  -It tends to be high in developing countries because wages and salaries are low

- It varies within the same country, depending on the expected profit rate:

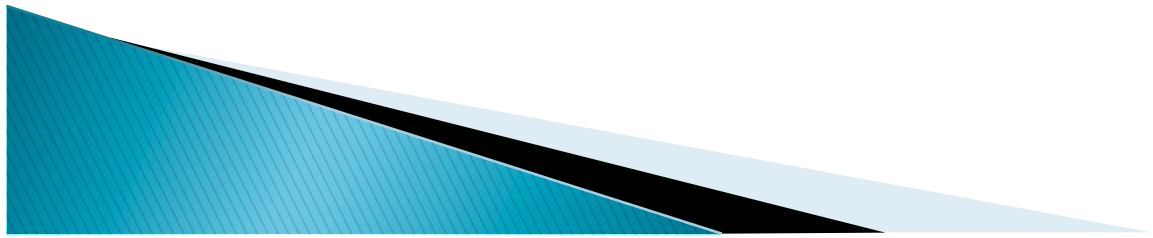
  -when the expected profit rate is very high, the mtc tends to diminish.



When dSi/dSx is usually small and GFSP is a sound policy

- When the country is already growing very fast,
  so that the expected profit rates are high
  and the marginal tendency to consume falls.

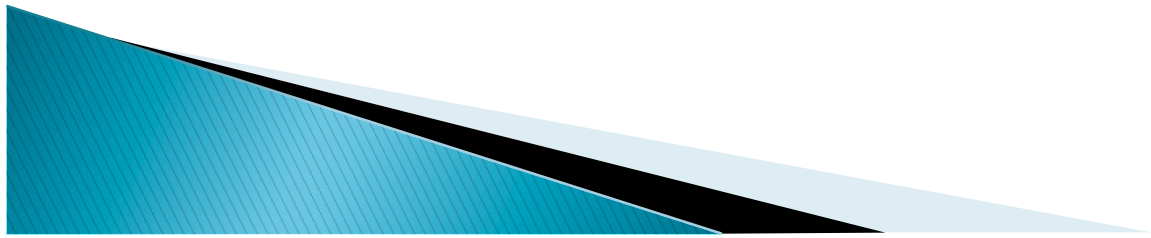
I believe that the last time that this happened in Brazil was in the 1978-1973 “miracle”.



We can have the inverse

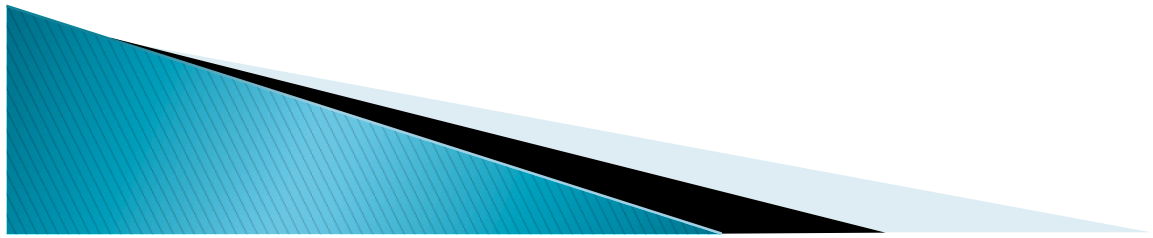
(substitution of domestic for foreign savings)

- when foreign savings change into foreign di-savings,
- and when foreign di-savings rise.

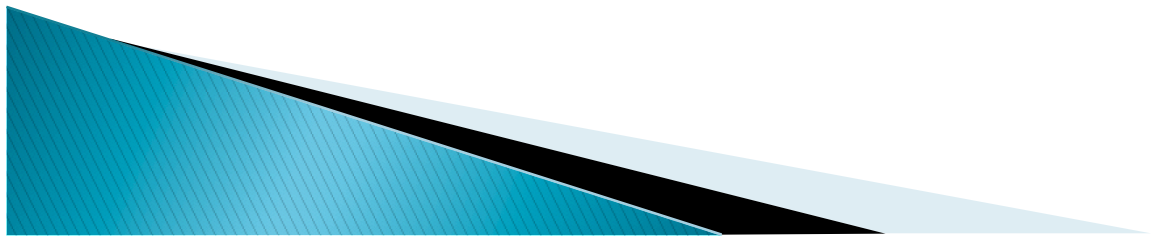


Brazil: Rate of substitution of foreign savings for domestic savings (1994–1999) and of domestic savings for foreign savings (1999–2006)

	Foreign Savings, Sx (% GDP)	**Domestic Savings, Si** (% GDP)	**Investment Rate** (% GDP)	**Period**	**ΔSx**	**ΔSi**	**ΔSi/ΔSx(%)**
1994	0,44	19,83	21,27				–
1999	4,73	14,17	19,20	1994-99	4.29	- 5.66	131.9
2006	-2,86	19,36	16,50	1999-06	- 7.59	5.19	68.4



- **6. Tendency to the overvaluation of the exchange rate and the closing of the model**



Tendencies in economics

- There are a few “structural” (independent of policies) tendencies:

-The tendency to the equalization of the profit rates

-The falling tendency of the rate of profits

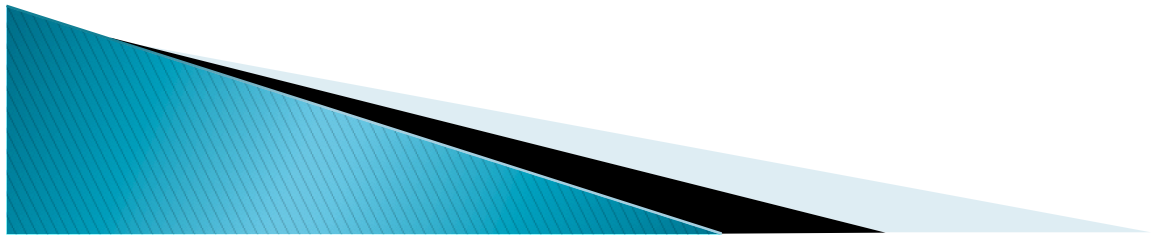
-To the deterioration of the terms of change

- I am proposing two new ones:

1. Tendency of wages to grow below the productivity rate
2. Tendency to the overvaluation of the rate of profit (TOER)

In developing countries the exchange rate

- Does not fluctuate around the current equilibrium (conventional economics)
- Nor is volatile around the current equilibrium (Keynesians)
- But shows a tendency to the overvaluation of the exchange rate
- It goes from currency crisis to currency crisis



As we already saw, the cyclical overvaluation of the exchange rate

is caused by

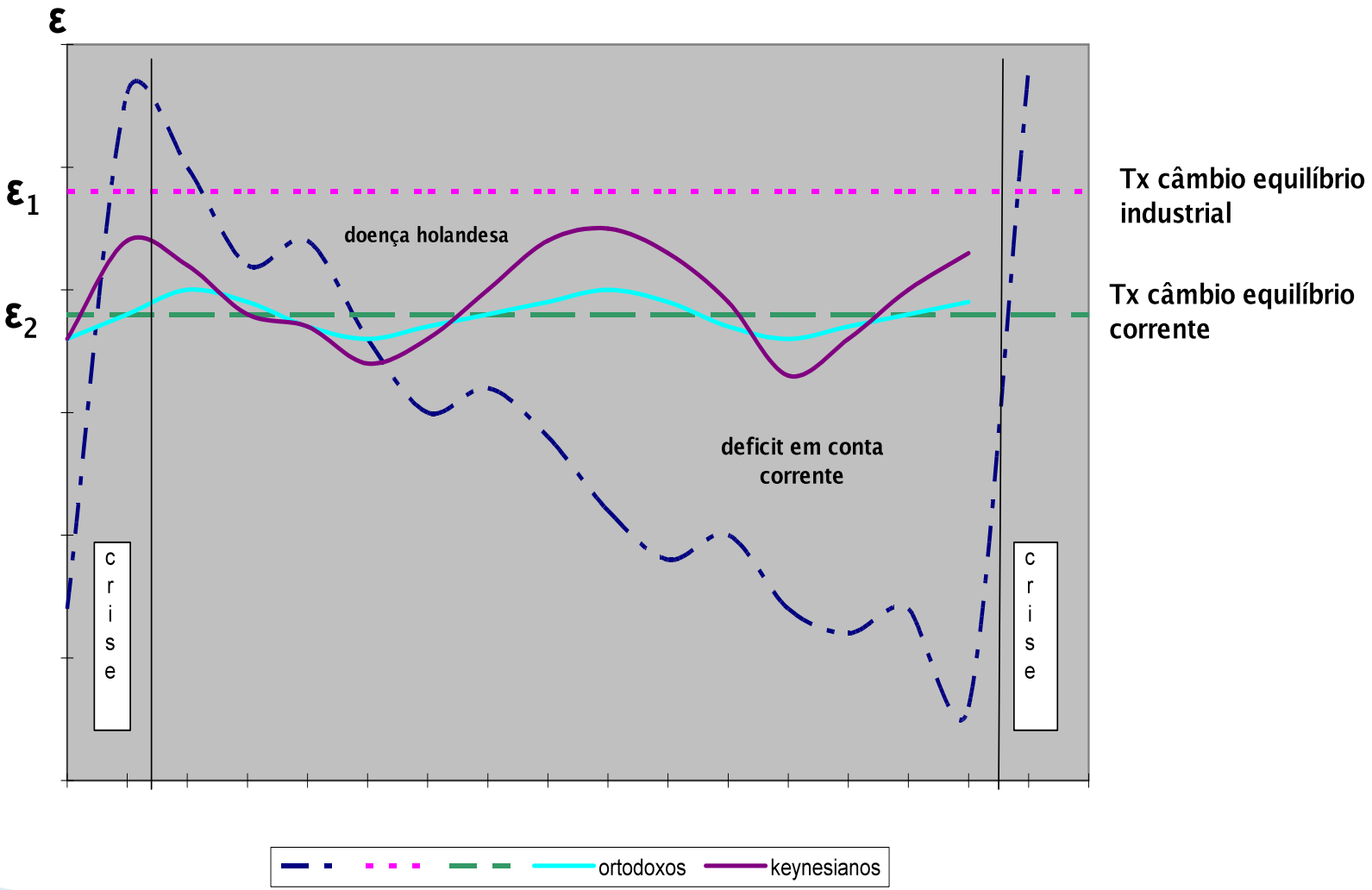
A) The Dutch disease (that is present in most developing countries)

B) The structural tendency to the profit and the exchange rate be more higher in developing countries – what attracts capitals.

C) Current policies: a) foreign constraint-foreign savings compound, b) anchor to inflation; c) exchange rate populism.

The cyclical process

- It begins with a crisis and a sharp devaluation causing the exchange rate to go above the industrial equilibrium level
- The Dutch disease (a first structural cause) brings it to the current equilibrium level
- The higher profit and interest rates attracting foreign capitals presses it down to the current account deficit area
- Depending on the level of the current account deficit and the speed it increases, foreign creditor suspend the rolling over of the debt.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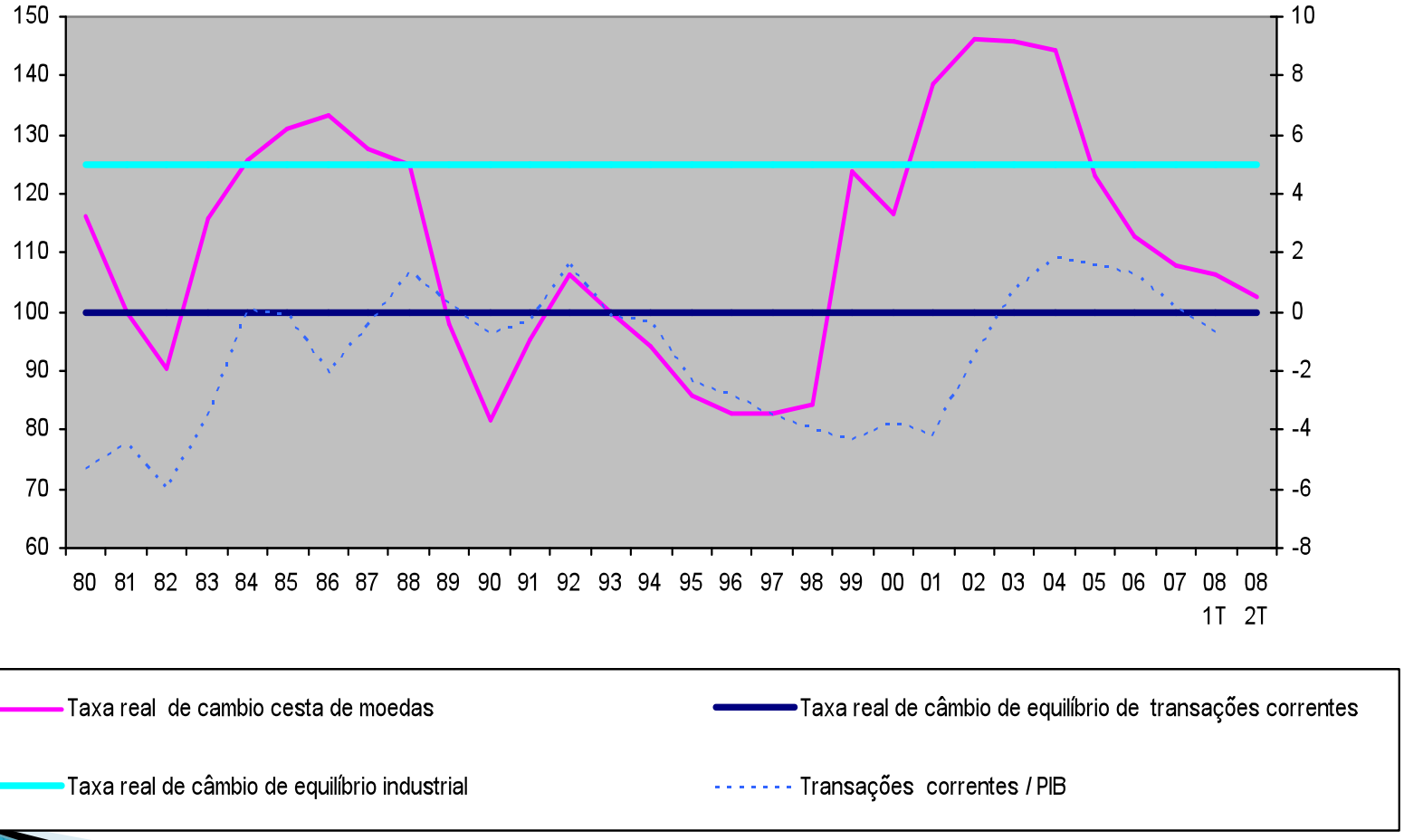
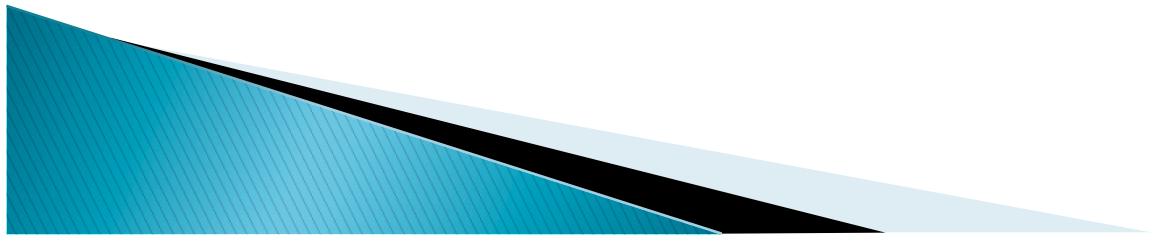
TAXA REAL DE CAMBIO EM RELAÇÃO A UMA CESTA DE MOEDAS (MEDIA 12 MESES, 1993 = 100) E SALDO EM TRANSAÇOES CORRENTES (% PIB)



The case of Brazil

- Sharp devaluations
- in 1981-83 – planned devaluation after monetarist experiment
- In 1997 – Moratorium
- In 1990 – balance of payment crisis
- In 1998 – balance of payment crisis
- In 2002 – balance of payment crisis
- (In 2008 – balance of payment anticipated crisis)

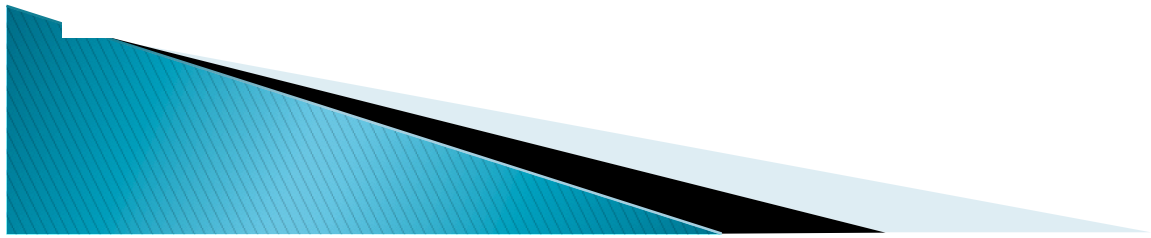


1. developmentalism and new developmentalism

Old developmentalism	New developmentalism
1. State-oriented industrialization, based on import substitution.	1. Export-oriented industrialization, combined with mass consumption on the domestic market.
2. State's key role in obtaining forced savings and making investments.	2. It is the state's duty to create investment opportunities and reduce economic inequalities.
3. The industrial policy is a key issue.	3. The industrial policy is subsidiary but strategic.
4. Ambiguity about public and current account deficits.	4. Rejection of both public and current account deficits. If the country has the Dutch disease, it should achieve a fiscal surplus and a current-account surplus.
5. A certain complacency regarding inflation.	5. No complacency regarding inflation.

1. Table 2: Conventional orthodoxy and new developmentalism (growth)

Conventional orthodoxy	New developmentalism
1. There is no economic role for the nation.	1. The nation is the agent responsible for the definition of a national development strategy.
2. The fundamental institution for growth is the guarantee of property rights and contracts.	2. The key institution for growth is a national development strategy.
3. Reforms should reduce the size of the state and deregulate markets.	3. Reforms should strengthen the state and markets – and the latter should be well regulated.
4. The state should not implement an industrial policy or a policy of redistribution.	4. Industrial policy should be limited and strategic, and play a major role in income distribution.
5. There are no structural tendencies to be neutralized.	5. The tendency to currency overvaluation and the tendency of wages to grow more slowly than productivity should be neutralized.
6. Growth should be financed largely by foreign savings.	6. Growth should be based on domestic savings.



1. **Table 3: Conventional orthodoxy and the new developmentalism (macro)**

Conventional orthodoxy	New developmentalism
7. The Central Bank has a sole mandate: low inflation. The rest of the administration should pursue other goals.	7. The government and the Central Bank have three mandates: low inflation, balanced exchange rate and full employment.
8. The fiscal standard should be defined in terms of primary surplus.	8. The fiscal standard should be defined more rigorously in terms of public deficit and public savings.
9. The exchange rate should be floating: no target or policy for the exchange rate.	9. The exchange rate should be floating but managed; the target is the industrial-equilibrium exchange rate.
10. The Central Bank and the government each have a sole mandate: to determine, respectively, the short-term interest rate and fiscal policy.	10. The Central Bank and the government may, in addition, buy reserves, impose capital controls, etc.
11. An income policy is not required or desirable.	11. Minimum wage and minimum-income policies should contribute to ensuring that wages grow as fast as productivity.

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