Finance, Growth and the Structuralist Development Macroeconomics

Luiz Carlos Bresser-Pereira

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Stylized facts in the financialized or neoliberal years

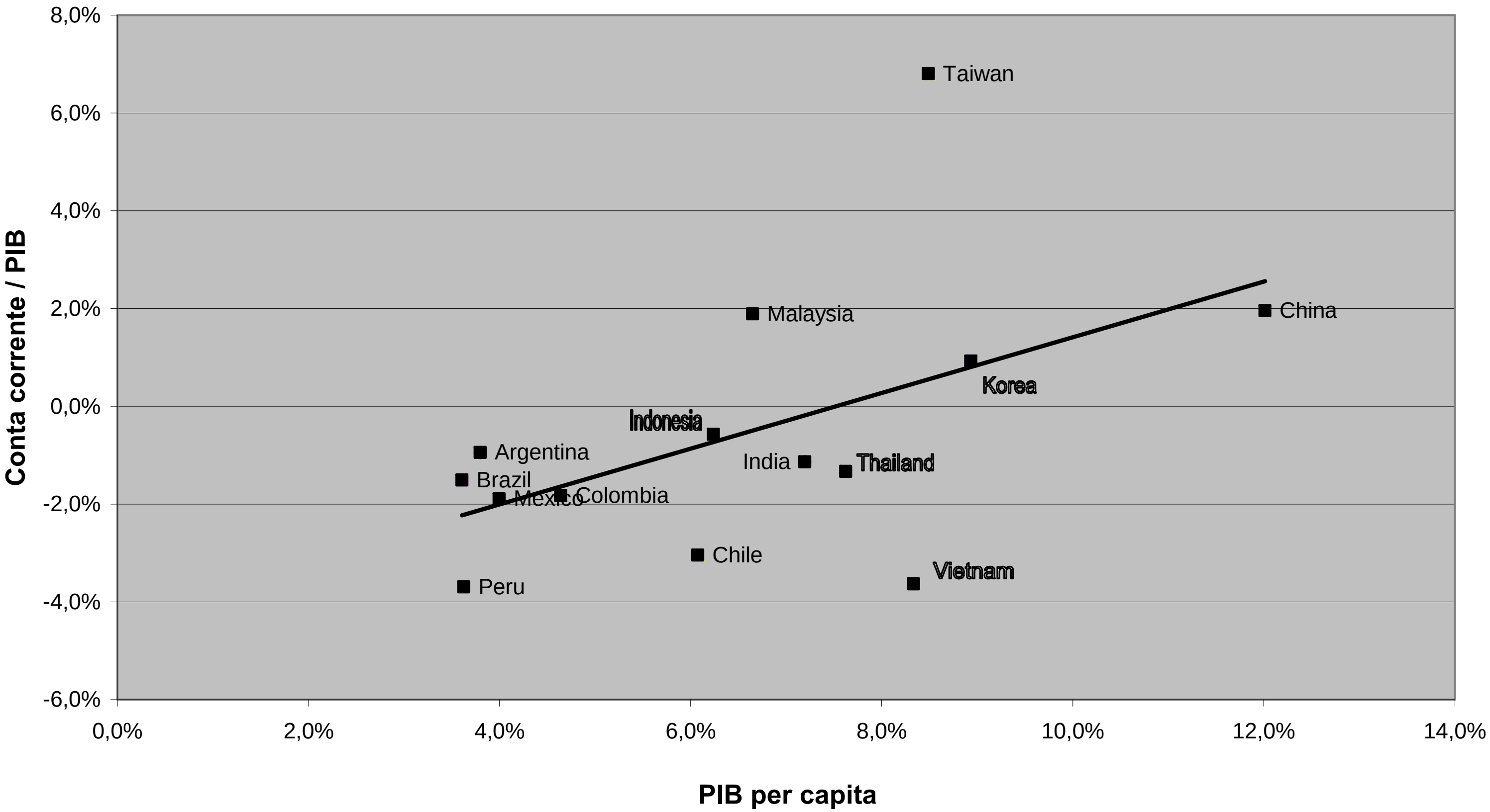
- The frequency of financial crises increased extraordinarily when compared with the golden years of capitalism (1949-1978).
- The global financial crisis was a banking crisis caused by financialization.
- Financial crises in Mexico, Brazil and Argentina, as well as of Thailand, Korea, Malaysia and Indonesia were were balance of payments or currency crises of countries persuaded to try to grow with foreign savings.
- The others (China, India, Taiwan and Vietnam) limited financial liberalization and continued to have as strategy to grow with domestic savings.

What did we learn?

- Liberalized financial markets and excess finance or high leverages were harming to rich as well as to middle income countries.

- The growth with foreign savings strategy was harmful to Latin American countries in so far as they were associated with major balance of payment crises and with low growth.

PIB per capita (PPP, var %) X Saldo em conta corrente (em % do PIB)
variação média entre 1981 e 2007



Brazil is the darling of the rich world

- Because it would be growing fast
- Its economic policies are very positively viewed, and
- Lula continues to be a “wonderful surprise” insofar as he proved “trustful”
- Only...

Whereas they are critical of China, India and Russia

- China, because it is nationalist, authoritarian and economically aggressive;
- India, because it is nationalist and resist reforms,
- Russia, because after the "reformist" Yeltsin years, it turned nationalist and even authoritarian with Putin

Is really Brazil the “best” BRIC?

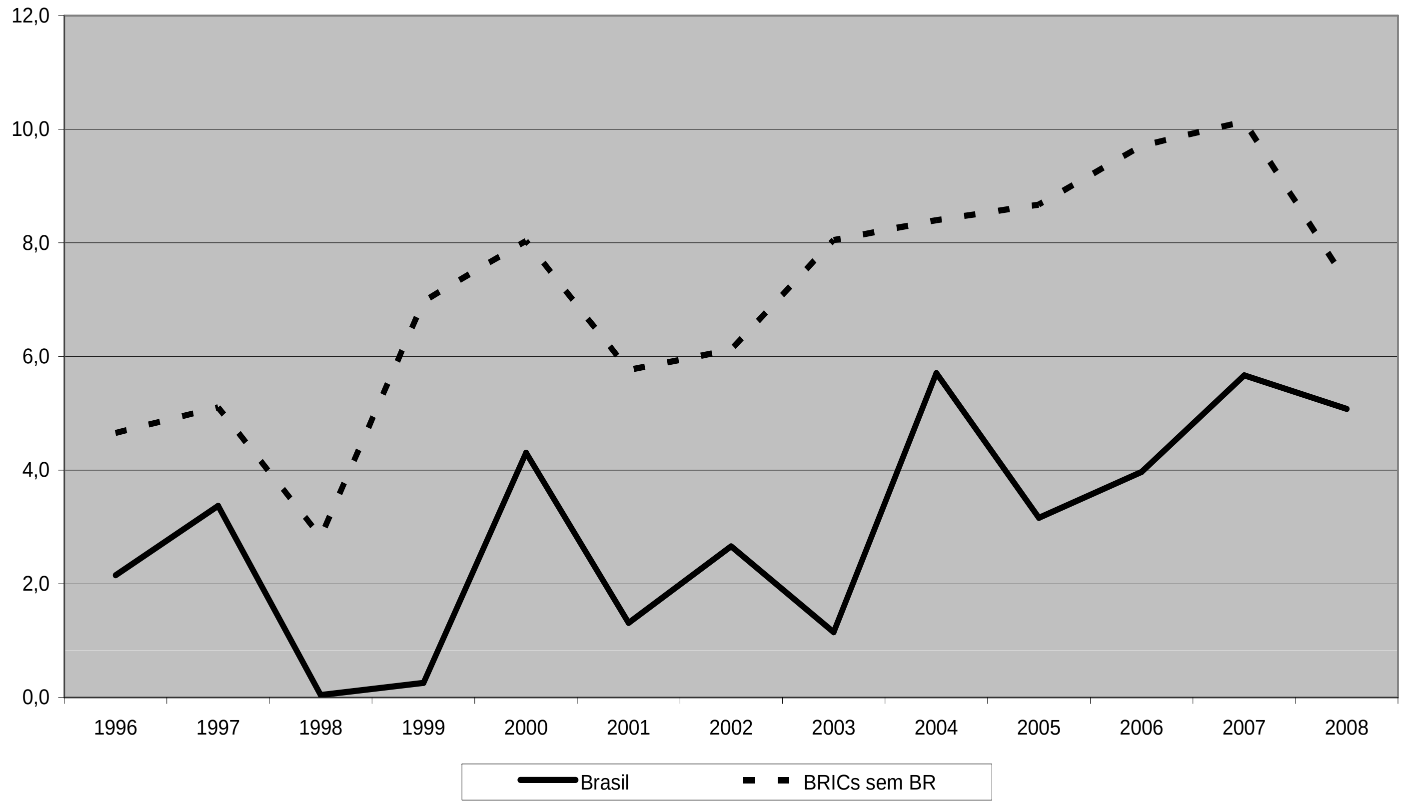
- On the stand point of Brazil’s economic growth, it is not.
- Between 1996 and 2008, whereas the yearly average rate of per capita growth of

  Brazil was 3% whereas

  of the other 3 BRICs, 7.1%.

- (Argentina’s: 4.75)

Brazil and 3 other BRICs compared



Why we are not the best?

- In the practical realm, because we lack the "new developmentalist" national strategy, and accept recommendations and pressures coming from Washington and New York.
- In the theoretical realm, because we were not able to update the Latin American structuralist development theory that was behind the region's fast growth between 1930 and 1980.

The new structuralist development macroeconomics

- 1.Growth depends on wages growing with productivity (to assure demand in the domestic market) and on the exchange rate being competitive.
- 2. A competitive exchange rate is the one that makes viable tradable industries using the best technology
- 3. There is a tendency to the overvaluation of the exchange rate in developing countries.

Causes of the structural tendency to the overvaluation of the exchange rate

a) the Dutch disease

b) the fact that the profit and the interest rate tend to be higher and attract capitals

c) the mistaken growth with foreign savings policy

d) the perverse use of the exchange rate to control inflation

e) exchange rate populism

a) The Dutch disease

- It is consequence of Ricardian rents
- It is defined by the existence of two exchange rate equilibriums: the "current" and the "industrial" – that makes viable tradable industries utilizing the best technology
- The difference between the two equilibriums indicates the gravity of the disease: in oil countries, it is very serious, in agricultural countries like Brazil, less serious but still limiting economic growth.
- Brazil ceased to neutralize the Dutch disease in 1990-1992.

b) Foreign capitals attract by higher profit and interest rates

- Involve appreciation of the exchange rate
- Increase in the real wage rate
- Increase in consumption
- Reduction of the domestic savings
- The substitution of foreign for domestic savings
- Increased foreign debt either patrimonial (when current account deficit is financed by direct investment) or financial
- Increased financial instability and possibility of balance of payment crisis

c) The mistaken growth with foreign savings policy

even if financed by direct investments, just accentuates overvaluation and the substitution of foreign for domestic savings.

- Historical experience shows that all countries grew essentially with domestic savings
- In Brazil, for instance, between 1994-1999,

foreign savings increased from 0 to 4.5% of GDP; But the investment rate remained 17%; Substitution was of 100%.

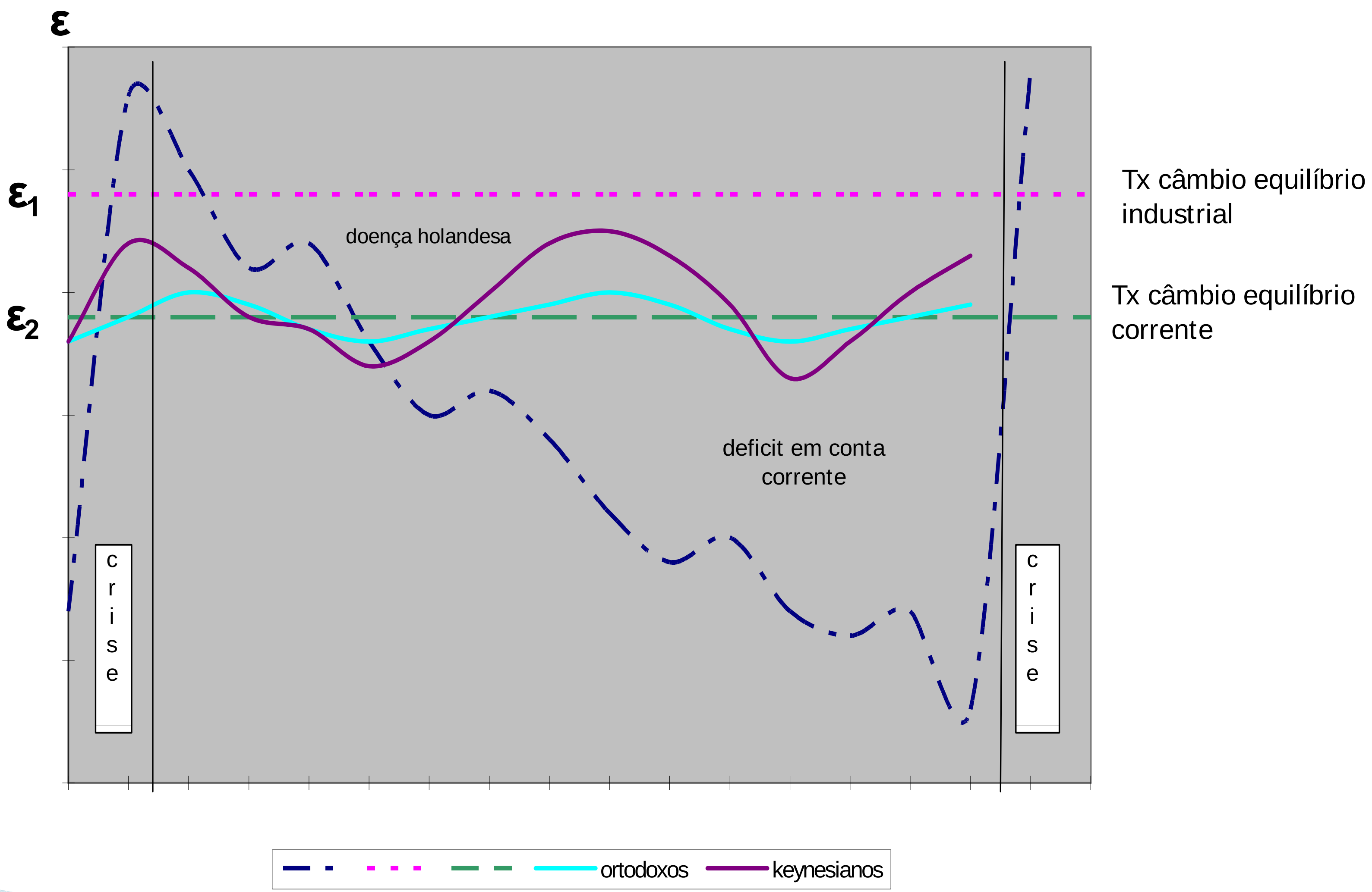
d) The use of the exchange rate to control inflation and

e) exchange rate populism

- The first is a <u>perverse form</u> of controlling inflation (it is only legitimate briefly, in the case of hyperinflations)

- Exchange rate populism is a <u>perverse use</u> of this perverse form to be reelected (if the balance of payment crisis does not happen before)

- Structuralist macroeconomics may be resumed in one figure



ε
ε1
ε2
doença holandesa
deficit em conta corrente
c r i s e
c r i s e
Tx câmbio equilíbrio industrial
Tx câmbio equilíbrio corrente
ortodoxos
keynesianos

New developmentalism

- Is the national-development strategy that follows from the structuralist development macroeconomics.
- It is the strategy that the fast growing Asian countries basically use
- It is the strategy that among Latin American countries, Argentina was the one that got nearer to it.

New developmentalism is based on

- 1. Wage policy to keep it growing with productivity (and assure domestic demand)
- 2. “No” to financial liberalization (to keep control of the exchange rate), but “yes” to trade liberalization (to take advantage of low wages).
- 3. Neutralization of the tendency to the overvaluation of the exchange rate (to assure foreign demand)
- 4. Fiscal responsibility
- 5. Moderate interest rates
- 6. Strategic industrial policy

Neutralization of the tendency to the overvaluation of the exchange rate

- (to make capable national firms competitive and assure them foreign demand) through:

a) growth with domestic savings

b) neutralization of the Dutch disease

c) fiscal surplus (due to the tax on exports of commodities originating the Dutch disease), and its use to build a sovereign fund (not just primary surplus);

This is essentially what fast growing Asian countries do

(except, in the take-off, when wages did not increase with productivity).

- They also face a moderate Dutch disease, originating from cheap labor combined with a much bigger wage span than the one existing in rich countries.

- For that reason they firmly manage their exchange rate

In Brazil, things have been changing in the last four years

- Central Bank's policy remains orthodox and wrong, but
- The policies enacted in the Finance Ministry and in BNDES are clearly developmentalist.
- The first pressures for lower interest rates and a competitive exchange rate
- BNDES is supporting major national business enterprises.
- The increase in loans by public banks was key to the short recovery of Brazil from the global crisis.
- Brazil's foreign policy demonstrates independence and moderation.
- Who knows? Brazil may eventually become a real BRIC.

Summing up

- To grow, middle income countries should take into consideration the structuralist development macroeconomics and adopt new developmentalism.
- They increase wages with productivity and neutralize the structural tendency to the overvaluation of the exchane rate, and grow with domest savings – not with foreign finance.