

## An account of new developmentalism and its structuralist macroeconomics

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This is a personal account of the definition of “new developmentalism” — a national development strategy alternative to the Washington consensus —, and of a “structuralist development macroeconomics”: the sum of models that justifies theoretically that strategy. It is personal account of a collective work involving Keynesian, institutionalist and structuralist economists in Brazil that are forming a new school of thought in Brazil: a Keynesian-structuralist school. It is Keynesian because it emphasizes the demand side or the investment opportunities’ side of economic growth. It is institutionalist because institutions obviously matter in achieving growth and stability. It is structuralist because it defines economic development as a structural change from low to high value added per capita industries and because it is based on two structural tendencies that limit investment opportunities: the tendency of wages to grow below productivity and the tendency to the cyclical overvaluation of the exchange rate.

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Over the past ten years, in cooperation with a skilled group of Keynesian and structuralist economists, I have been developing a *structuralist macroeconomics of development*, that is, a demand-side theory of development based on structural tendencies that constrain investment opportunities and limit the rate of growth of developing countries. On the other hand, based on the Latin American experience with national developmentalism (1930-1980) and the past 20 years’ growth experience of dynamic Asian countries, we have been drafting a national development

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strategy: *new developmentalism*. Several economists in various countries are developing the new ideas, but I will limit myself to Brazil. I exposed them in a systematic manner in the book *Mondialisation et Compétition* (2009).

Structuralist development macroeconomics and the new developmentalism both take account of medium-income countries that have already undergone their national and capitalist revolution. New developmentalism is a third discourse, an alternative, on one side, to the Washington consensus for which the solution of all problems lies in reducing the public deficit, and, on the other side, to the populist approach that views fiscal expansion as such magic solution and is not responsible in exchange rate terms as it proposes growth with foreign savings. Instead, new developmentalism proposes a strategy based on fiscal responsibility and principally foreign exchange responsibility.

Structuralist development macroeconomics, in its turn, is the new Keynesian-structuralist theory that founds new developmentalism. It is based on two structural tendencies that limit investment opportunities: the tendency of wages to grow below productivity and the tendency to the cyclical overvaluation of the exchange rate. With this second tendency and the two models behind — the Dutch disease model and the critique of growth with foreign savings — the exchange rate is viewed as key macroeconomic price for development economics. While structuralist economics focused in the critique of the law of comparative advantages, structuralist development macroeconomics see a chronically overvalued currency as the major impediment to growth. While neoclassical economics sees the exchange rate to fluctuate softly around the current account equilibrium, and Keynesian economics sees it fluctuating with high volatility around such equilibrium, structuralist development macroeconomics sees it as going from currency crisis to currency crisis due to the Dutch disease and capital inflows caused by the growth cum foreign savings policy, the adoption of exchange rate anchors to control inflation, and exchange rate populism. The exchange rate plays the role of a “light switch” that connects, or disconnects, local manufacturing business enterprises using technology in the state of the art from foreign markets if the exchange rate is, or is not, in equilibrium or competitive. In so far as the exchange rate is overvalued — does not correspond to the “industrial equilibrium” — local entrepreneurs are denied profitable export oriented investment opportunities, and the country fails to take profit from its major advantage in catching up: its low labor costs.

## THE CRITIQUE OF GROWTH WITH FOREIGN SAVINGS

My two first attempts toward a structuralist development macroeconomics were the paper that I wrote in 1999 while in Oxford, just after leaving the Brazilian

administration, “Latin America’s quasi-stagnation”, and a short article where I drafted the critique of growth with foreign savings, “A fragilidade que nasce da dependência da poupança externa” [The fragility that springs out of dependency on foreign savings] (2001). Upon my return to Brazil, I wrote “Uma estratégia de desenvolvimento com estabilidade” [A strategy of development with stability] (2002) with Yoshiaki Nakano, my partner in many academic battles. That paper carried out our first systematic criticism of the Central Bank of Brazil’s high interest rate policy, and showed that this rate did not correspond to Brazil’s sovereign risk, but to a policy of high interest rates that the Brazilian society had come to accept in so far as it was persuaded that it was a condition to keep inflation under control. In this paper was present an idea that came to be known as the “Bresser-Nakano interest rate hypothesis”: the causal link between sovereign risk and interest rates reversed beyond a certain threshold: high interest rates become a determinant of the risk of default. The paper caused for the first time in many years intense debate involving orthodox and heterodox economists.

I was convinced, however, that in addition to criticizing the interest rate policy, there was also a need to reevaluate the role of the exchange rate in economic growth. I knew for long that a “relatively depreciated” foreign exchange rate was crucial to economic development. In 2001, while attending a meeting of the National Forum organized by João Paulo dos Reis Velloso, it suddenly became clear to me that the foreign exchange rate was kept chronically appreciated as a result of the policy of growth with foreign savings, that is, of growth with current account deficits. I first inverted the usual connection between foreign exchange rate and the current account deficit, arguing that the policy of growth with foreign finance or current account deficits *caused* the overappreciation of the exchange rate. The policy was the independent variable and the foreign exchange rate, the dependent one. Secondly, I established a connection between foreign exchange rates and growth. On one hand the overappreciated exchange rate stimulated consumption as it increased artificially real wages; on the other hand, it reduced the export oriented investment opportunities, making the investment and the growth rates smaller than otherwise would be. The foreign exchange rate is a demand-side factor of economic development. With a competitive foreign exchange rate, business enterprises using modern technology will have access to the entire foreign demand; with an appreciated rate, this access is barred. In 2001 I began my critique of the growth cum foreign savings strategy in a short article already referred. In the next year, I invited Yoshiaki Nakano to co-write “Economic growth with foreign savings?” (2003). Also in 2002, I applied the new ideas including the critique of the opening of the capital account (that was not part of the *first* but of the *second* Washington consensus) in the paper “Financiamento para o subdesenvolvimento: o Brasil e o Segundo Consenso de Washington” [Financing development and the second Washington consensus]. In 2007, in a

paper with Paulo Gala, “Why foreign savings do not cause growth”, this model explaining why foreign savings do not cause growth was formalized, and, in the next year, again with Gala, in “Foreign savings, insufficiency of demand, and low growth”, the key relation between exchange rate overvaluation and demand was explained (2008).

It was clear to me that a new theory and a new set of economic policy proposals were emerging. In early 2003, Nakano and I had already assembled a set of ideas that justified a specific name for the proposals we were making. I asked him what we might call them, and immediately accepted his suggestion: “new developmentalism”. I was writing the fifth edition of *Development and Crisis in Brazil* (2003) and, in its final chapter, “Resuming the national revolution and the new developmentalism,” I, for the first time, used this expression. The new developmentalism was based on a strategic role for the state, on growth with domestic savings, on fiscal balance, on a competitive foreign exchange rate, and on the development of a domestic mass consumer market.

At the same time, I was attempting to gather around the new ideas younger and competent macroeconomists, either Keynesian, such as Fernando Cardim de Carvalho, Luiz Fernando de Paula, José Luiz Oreiro, Fernando Ferrari and João Sicsú, or structuralist, like Ricardo Carneiro, Daniela Prates and Franklin Serano. The annual meetings of the Political Economy Society were helpful to this end. An important step was taken in 2005 with the publication of *Novo-desenvolvimentismo* [New developmentalism], a book that João Sicsú, Luiz Fernando de Paula and Renaut Michel edited. In the introduction they defined new developmentalism as being characterized by the following guidelines (2005, p. xxxv): “(1) there is no strong market without a strong state; (2) there will not be sustained growth [...] without strengthening [...] the state and the market and without the implementation of appropriate macroeconomic policies; (3) a strong market and a strong state can only be built by a national development project that aligns growth [...] and social equity; and (4) it is not possible to [reduce] inequality without economic growth at high and sustained rates”. In this book I made my first attempt to present a model of the Brazilian economy accordingly: “Macroeconomia pós-Plano Real: as relações básicas” [Pos Real Plan macroeconomics: the basic relations].

In 2006, I wrote my first systematic paper on the new developmentalism, “The new developmentalism and conventional orthodoxy” (2006), in which I argued that from 1930 to 1980 Latin American countries, mainly Brazil and Mexico, had experienced strong growth based on structuralist ideas and on a national developmentalist strategy, but they fell into the foreign debt crisis in the 1980s and, since the end that decade bowed to the Washington consensus. I then compare the new developmentalism with old national developmentalism, and with conventional orthodoxy, arguing that the new developmentalist policies are best funded theoretic-

cally and more responsible than their neoliberal counterparts. In that same year, Luiz Fernando de Paula published “Repensando o desenvolvimentismo” [Rethinking developmentalism] (2006) and, the year next Sicsú, Paula and Michel (2007) expanded upon the introduction of the book they had previously edited: “Por que novo-desenvolvimentismo?” [Why new developmentalism?]. In 2006, my student, Paulo Gala, concluded an excellent PhD dissertation: *Política Cambial e a Macroeconomia do Desenvolvimento* [Foreign Exchange Policy and the Macroeconomics of Development]. In the next year, another student, Lauro González presented his doctoral dissertation, *Crisis Financeiras Recentes: Revisitando as Experiências da América Latina e da Ásia* [Recent Financial Crises: Revisiting the Latin American and Asian Experiences] (2007), in which he shows that the several financial crises that developing countries faced in the 1990s were caused not by excessive public deficits, but by current account deficits, that is, by the policy of growth with foreign savings.

## THE DUTCH DISEASE

In the same time, I was working on another model relating foreign exchange and economic development: the problem of the Dutch disease. In 2005, in a short article in the *Folha de S. Paulo*, I raised the question and a broad discussion on whether or not the Dutch disease occurred in Brazil followed. Realizing that I had really new ideas on the subject — a possible progress in relation to the classical paper of Corden and Neary (1982), I decided to write the theoretical paper, “The Dutch disease and its neutralization: a Ricardian approach” (2008), while I co-authored with Nelson Marconi a first study on the Dutch disease in Brazil (2007). I had, however, a problem in concluding my model. If Brazil had always been a case of Dutch disease, how had the country industrialized so successfully between 1930-1980 without acknowledging and deliberately fighting the obstacle? I posed the question to Gabriel Palma, who promptly answered: “but Luiz Carlos, we, in Latin America, did nothing other in that period than neutralize the Dutch disease”. He didn’t have to say anything else. I immediately remembered the Brazilian controls on the foreign exchange rate and the taxation of coffee exports known as “confisco cambial” (“foreign exchange expropriation”), and went on writing my paper. Writing it was a theoretical adventure, a succession of discoveries. I defined the Dutch disease as the long-term overappreciation of the exchange rate due to Ricardian rents associated with one or more commodities that can be exported with a profit at a more appreciated foreign exchange rate than the one required by manufacturing industries using world state of the art technology because their cost or production is substantially smaller than their international price. Another way of defining the Dutch disease is to say that is

characterized by two equilibrium exchange rates: the “current equilibrium” that balances intertemporally the country’s current account, and the “industrial equilibrium” — the one required by efficient manufacturing industries. I showed that the Dutch disease is a permanent market failure, since the country fails to industrialize but keeps its foreign accounts in balance. I showed that its gravity varies according to the size of the Ricardian rents or the gap between the industrial and the current exchange rate equilibrium. I showed that countries endowed with cheap labor and a wide range of wages such as China also need to neutralize their Dutch disease. I showed that its neutralization occurs mainly through the imposition of a tax on the exports of the commodity originating the disease, because the tax shifts up the supply curve of the commodity in relation to the nominal exchange rate (not the international price that remains constant). Such neutralization policy gets stronger with the creation of a sovereign fund, so that the proceeds of the tax do not imply capital inflows. I showed that the countries that did neutralize it had current account surpluses and, in theory, fiscal surpluses as well. I rejected the distinction between the Dutch disease and the “natural resources’ curse” — a distinction that allows its advocates to “forget” the overappreciated foreign exchange rate and blame the country’s low growth rates on the rent-seeking or corruption that the export tax (usually insufficient) instigate among local politicians and bureaucrats. Although this ethical problem does exist, it must not be used to dismiss the economic problem that lies in overappreciation. After writing this article, I stop saying that economic development requires a “relatively depreciated” foreign exchange rate; instead, what it needs is a competitive exchange rate, i.e., an exchange rate kept on the industrial equilibrium. My book *Macroeconomia da Estagnação* (2007) translated to English as *Developing Brazil — Overcoming the Failure of the Washington Consensus* (2009), applied these models to the Brazilian economy.

## THE TWO TENDENCIES

But the configuration of a structuralist macroeconomics of development only got completed in the following year, when I defined the two structural tendencies that characterize developing countries: the tendency towards the cyclical overappreciation of the exchange rate and the tendency of wages to grow less than productivity. The two tendencies reduce demand — foreign in the case of the former and domestic in the case of the latter — and consequently reduce investments and savings. On the first tendency I wrote “A tendência à sobreapreciação da taxa de câmbio” [The tendency to the overappreciation of the exchange rate] (2009) while *La Découverte* published, in French, *Globalization and Competition* — a book that in 2010 also appeared in English, Portuguese and Spanish.

In this book, although not mentioning the constitution of a structuralist development macroeconomics, I was for the first time sum up the new ideas. The French and the Portuguese editions counted with a foreword by Robert Boyer in which he mentions that a school of thought is emerging in Brazil. Although domestic demand is fundamental to economic development, I did not invest my time on the discussion of the tendency of wages to grow below the productivity rate because many other economists, and mainly Celso Furtado, had already discussed the matter sufficiently and because the book focused on the foreign exchange rate — on the theoretical claim that fast economic development depends crucially on a competitive exchange rate.

In that book I attempted to lay the groundwork for a macroeconomics of development, but it only became clear to me that it was a *structuralist* macroeconomics in 2009, after the book's publication in France. Earlier that year, José Antônio Ocampo had invited me to write a paper on the new developmentalism for the *Handbook on Latin American Economics* he was editing with Jaime Ross. I did write it. Soon afterwards, however, Osvaldo Sunkel asked me to write a paper, again about the new developmentalism, for the *Revista de la Cepal*. That was when, in a conversation with Paulo Gala, I realized that the new ideas that had been emerging might stand as a *second moment* in the structuralist theory of development. The first one covered the 1940s-1960s and became exhausted in the 1970s under misguided criticism from the “theory of dependency” and, later, beginning in the 1980s, under criticism from the prevalent neoclassic orthodoxy. Now, however, a body of thought was emerging that might supplement and update structuralist thinking — not only the Latin American structuralist thinking, but the entire system of thought of *development economics* which, as according noted by Albert Hirschman (1981), had also fallen into a crisis in the 1970s. According to Osvaldo Sunkel's 2009 invitation, the paper should have been published in issue #100 of the *Revista de la CEPAL*, but I was about 20 days late delivering it, and it was eventually slated for the next issue and, finally was translated and ready for publication in issue #102. Meanwhile in Brazil, the October 2010 issue of *Revista de Economia Política* published its version in Portuguese, “Structuralist macroeconomics of development”. For this formal reason, and despite Osvaldo Sunkel's disagreement, the Eclac's bureaucracy refused publication. I am now (2011) preparing a new paper, “Structuralist macroeconomics and new developmentalism”, that will summarize the new thing in English.

## TEN THESES ON NEW DEVELOPMENTALISM

In the meantime, and notwithstanding the Eclac's bureaucracy, new developmentalism and structuralist development macroeconomics continued to gain

ground. In 2009, José Luís Oreiro and Luiz Fernando de Paula circulated the paper “O novo desenvolvimentismo e a agenda de reformas macroeconômicas para crescimento sustentado com estabilidade de preços e equidade social” [New developmentalism and the agenda of macroeconomic reforms for sustained development with prices stability and social equity], in which they state that “the new macroeconomic model for Brazil should be based on the pillars: flexible inflation targets regime, a fiscal regime based on the generation of government current account surpluses generation, and foreign exchange rate management, thereby creating the conditions for a lower interest rate and a more competitive foreign exchange rate.” In September 2010, at the third international meeting of the Brazilian Keynesian Association, in São Paulo, I presented the basic ideas of the structuralist development macroeconomics. That same year, at the University of Brasília, José Luís Oreiro organized a research group for the “Structuralist macroeconomics of development” and created a blog for this group, with contributions from the already quoted economists plus Carmen Feijó, Frederico Gonzaga, Jennifer Hermann, Marco Flavio Resende, Maria de Lourdes Mollo and Rogério Sobreira. In 2011 I published in the *Brazilian Journal of Political Economy* “Uma escola de pensamento keynesiano-estruturalista no Brasil?” [A Keynesian-structuralist school of thought in Brazil?] in which I listed the 54 propositions that form structuralist development macroeconomics and new developmentalism.

In May 2010, with support from the Ford Foundation, I organized an international workshop in São Paulo on the 10 Theses on New Developmentalism — a clear alternative to the Washington Consensus. Approved and underwritten in the months that followed by a large number of acknowledged economists and political scientists around the world, the document now has its own Website and the Ten Theses are published in various languages to allow other economists and interested citizens to underwrite them. In this way, new developmentalism became an institution. Now, in early 2011, structuralist development macroeconomics is open to additional contributions from Keynesian-structuralist economists that refuse orthodoxy in any shape because orthodoxy is ever an arrogant refusal of thinking and criticism.

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