

DUTCH DISEASE AND DE-INDUSTRIALIZATION

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Valor Econômico, November 25, 2009

Brazilian de-industrialization is evident. People resist to acknowledge that because in the moment they do that, a new exchange rate policy turns inevitable

After the sudden depreciation of the real caused by the global financial crisis, the tendency to exchange rate overvaluation existing in Brazil reappeared and the current account is already in deficit. It is still a small deficit, because it happens in a Dutch disease setting that, by definition, implies overvaluation but is compatible with equilibrium in the current account. The severity of the Dutch disease existing in each country can be measured by the difference between two equilibrium exchange rates: the current equilibrium rate, that balances the current transactions account, and the industrial equilibrium exchange rate - which is necessary to make viable industrial enterprises using the most modern technology. In a country that is not yet industrialized, as most of the oil-exporting countries, the Dutch disease means low growth and continuous poverty in an industrialized country such as Brazil, the overvaluation provokes de-industrialization even when the current account is balanced.

When a country with the Dutch disease goes into current account deficit, this is due to the "growth with foreign savings policy" or to carry trade operations. In Brazil, as long as we do not limit these two practices and we do not neutralize the Dutch disease, we are already being suffering from de-industrialization. It is not an acute de-industrialization, because the Dutch disease in Brazil is not comparable to the one existing in oil-exporting countries. Since the Dutch disease is also associated with low

wages prevailing in low-technology industrial sectors, the industrial sectors most severely affected by the Dutch disease are those with higher technological content and, therefore, with higher value-added per capita. These are the sectors that should lead the country's process of economic development, because they engender technical progress, increasing returns and positive externalities instead, they are lagging behind.

Since in Brazil the Dutch disease is not as obvious as it is in oil-exporting countries, the analysts deny its existence. They argue that the country continues to increase its industrial production and its exports. Which is true. Besides, since the domestic market grew significantly due to the government's distributive policies, those analysts understand that industrial companies are investing, and once again refuse to recognize de-industrialization. Notwithstanding, whereas China becomes the world's factory and India, the universal producer of software, Brazil gradually becomes the world's farm.

Between 1930 and 1980, Brazil presented the world's highest growth. This happened because, during that period, although with brief interruptions (1945-47, 1961-64), the Dutch disease was neutralized in Brazil by the taxation of primary goods exports (which was called "exchange rate confiscation") and by a firm management of the exchange rate. As of 1990, however, the trade opening and particularly the financial opening put an end to this neutralization. In the period 2002-2008, the rise in the prices of commodities exported by Brazil promoted a certain resumption of growth based on the agribusiness, but, as a trade-off, the Dutch disease worsened. There is no contradiction in this fact. The Dutch disease is the product of Ricardian rents resulting from cheap and abundant natural resources that, in principle, are a blessing to the country, but become a curse if the country is not able to prevent the overvaluation of the domestic currency that is associated with the Dutch disease.

There are several forms of evaluating the process of de-industrialization. One of them is to compare, in each sector, the part of the value added in the total amount of the industrial production in the phase 1996-02 with its part in the period in which the rise in international prices of commodities implied a continuous exchange rate appreciation

(2003-07). According to IBGEs [*Brazilian Institute of Geography and Statistics*] Annual Industrial Survey, this part decreased by 12.7% in the manufactured goods sector and increased by 2.3% in the primary goods and associated products. The decrease is higher (14.4%) for manufactured goods of high and medium-high technology.

Another way of evaluating de-industrialization is to examine the exports in the period between 1997 and 2008. During that period, primary products exports grew more (366%) than the exports of manufactured goods (244%): 35% more for the primary products.

A third way: the imports of primary products increased by 26% between 1997 and 2008, whereas the imports of manufactured goods increased by 154%. The difference is substantial, confirming the decrease in the value-added exported.

And, finally, de-industrialization appears at investment level. Probably as a consequence of the strategy of substitution of imported inputs for national inputs that companies were forced to use, industrial investments grew very little. Data from IBGEs Annual Industrial Survey show that actual investments in the commodities sector, in the period 1997-08, increased by 277% (14.2% per annum, 11% without considering oil extraction and refinement), whereas in the manufactured goods sector investments increased far less, only by 30% (2.7% per annum).

Brazilian de-industrialization is, therefore, evident. A change in this setting requires a new exchange rate management policy. Conventional economists, however, ignoring both world and Brazilian experiences, argue that it is impossible to manage the exchange rate in the long run. As long as Brazilian society does not realize the fallacy of this antinational position, the government will not feel strong enough to adopt a more decisive policy of exchange rate management and of neutralization of the Dutch disease. Consequently, Brazilian per capita growth rates will continue to be roughly half the rates observed in the dynamic Asian countries. We will have some moments of

euphoria, as the one that is happening again now, but those periods of apparent and ephemeral prosperity will not be enough to induce Brazil's sustained growth in the long run.