Developmental macroeconomics

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New Developmentalism

- It originates from

1. Development Economics or Classical Developmentalism (Nurkse, Lewis, Prebisch, Furtado)
2. Post-Keynesian macroeconomics

- It is divided into

1. New-developmental macroeconomics
2. New-developmental political economy
3. New developmental microeconomics (just a draft)

- It is focused on middle income countries,
- whose key difference in relation to rich countries is that it gets indebted in foreign money.

Main differences in relation to classical developmentalism and post-Keynesian macro

- It is focused in the five macro prices
- It is focused on the exchange rate, the current account deficit, and the expected profit rate.
- It is based on the tendency to the overvaluation.
- Its investment function includes the exchange rate, which tends to not give access to demand.
- Has a new model for the Dutch disease.
- Rejects growth with foreign savings.
- Defends an active exchange rate policy.
- Defends a manufactured goods export-led strategy.

Historical-deductive method

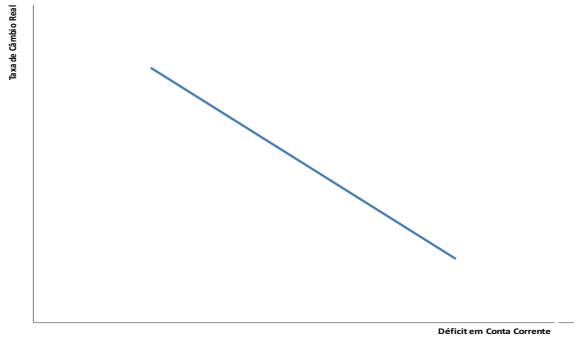
- ND adopts the historical-deductive method of Smith, Marx and Keynes.
- It rejects the hypothetical-deductive method, which is valid for methodological sciences as econometrics and economic decision making theory, not for a social science as economics is.
- Yet, it accepts some theorems – logical constructs like the law of comparative advantages, or the Balassa-Samuelson effect.
- But just as logical relationships, not as generalization of habitual behaviour. That is what do historical models
- From theorems one does not derivate policy. To do that is to fall into Schumpeter's "Ricardian vice".
- Policy must de derivate from historical models.
- The historical models don't lead to certitudes, but to things that happen "generally", "probably".

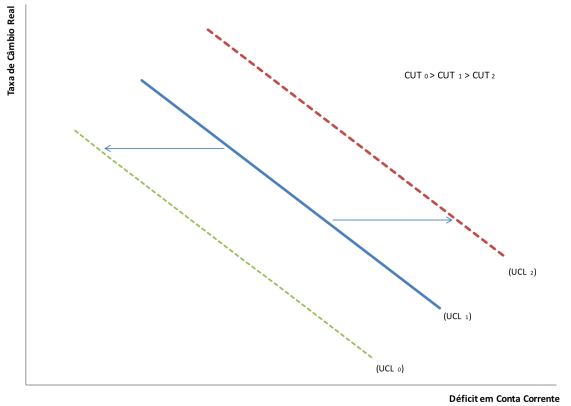
Developmental macroeconomics' major theoretical claims

1. There is a tendency to the cyclical and chronic (long-term) overvaluation of the exchange rate.
2. Investment depends on the ER, because the access to demand depends on it.
3. The determination of the exchange rate depends on its value and the demand of supply of foreign money.
4. The value depends on the CULCI and the terms of trade.
5. The demand & supply of foreign money depend on three habitual policies and on text-book variables.
6. A new definition of Dutch disease.
7. Foreign savings rather replace than add to domestic.
8. There is a inverse relation between the exchange rate and the current account, which is not linear because moves with changes in the value of the exchange rate.

Inverse relation: exchange rate and the current-account

- There is an inverse and linear relation between both for each moment.
- The more valorized the exchange rate, the larger the current_account deficit, and vice_veresa.
- Variations in the ICCUT cause shfits of the line and consequentmovements up and down in the current equilibrium and, mainly, the industrial equilibrium.





Developmental macroeconomics' policy key claims

- The five macroeconomic prices must be "right"

1. The profit rate must be satisfactory
2. The level of the interest rate must be low
3. The value of the exchange rate must be the industrial equilibrium.
4. The wages must increase with productivity
5. Inflation must be low.

- A competitive nation-state must not incur current-account deficits because this will appreciate the national currency.
- A capable state must limit budget deficits and show a small public debt.

The five "right" macroeconomic prices

Quite different from neoclassical "right prices".

PRICES	THEY ARE RIGHT WHEN
Profit rate	Satisfying
Exchange rate	Assures satisfactory profit rate to competent firms
Interest rate	Low level, around which to conduct monetary policy
Wages	Conistent with satisfying profit rate (growing with productivity)
Inflation	Below one digit

Investment function
(on what depends the investment rate)

- Classical school: it depends on the expected profit rate and the interest rate;
- Keynes: OK, but the expected profit rate depend on demand, which is not assured by the market.
- New developmentalism: OK, but the expected rate of profit depends also on the access to demand, which is not assured when the exchange rate is overvalued in the long-term.

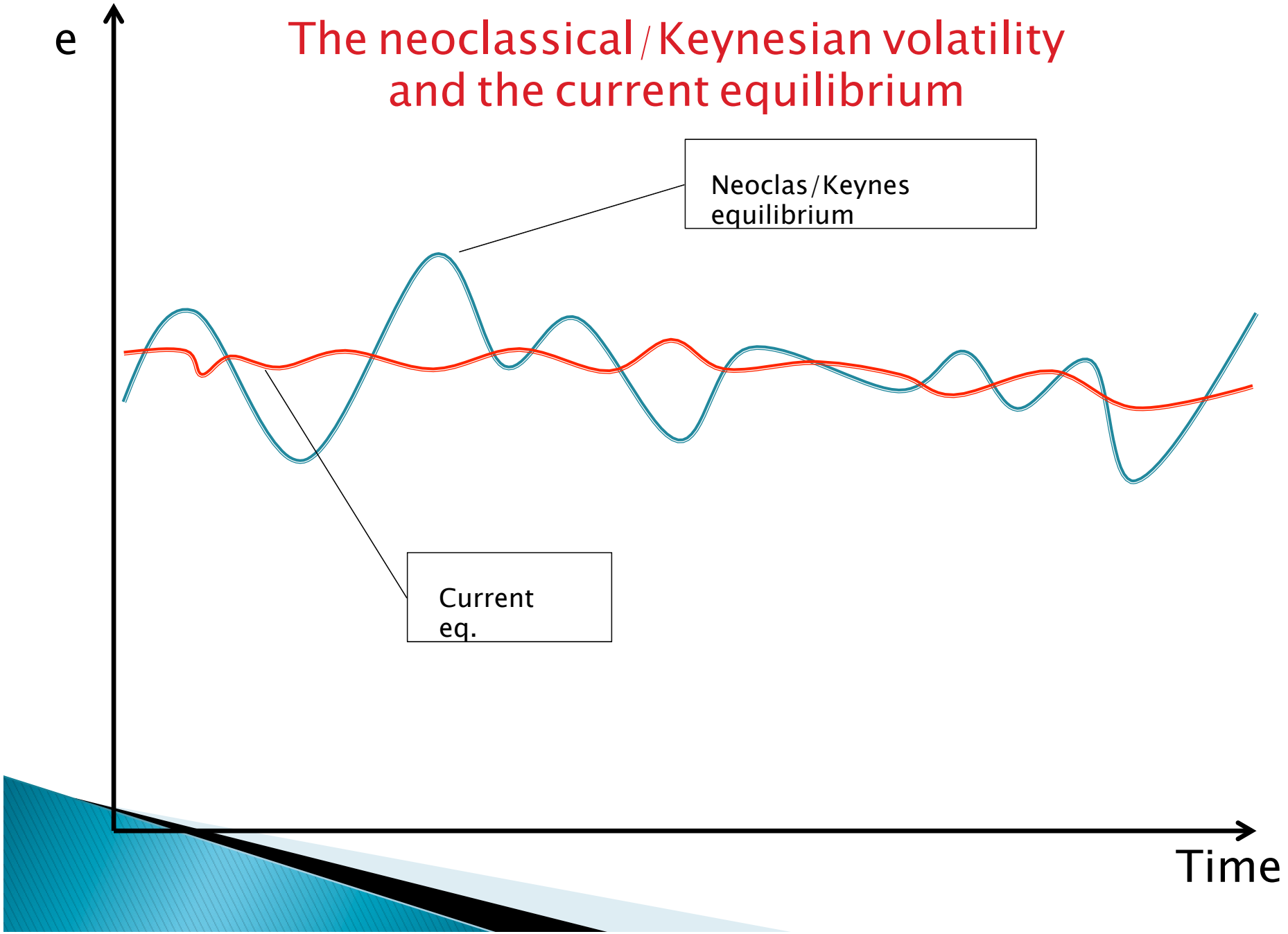
Historical tendencies & Tendency to the overvaluation of the ER

- Classical school: tendency to the falling rate of profit.
- Keynes: tendency to the insufficiency of demand.
- Classical developmentalism: tendency to the deterioration of term of change.
- New-developmentalism: tendency to o the cyclical and chronic (long-term) appreciation of the exchange rate.
- (Neoclassical economics does not have a tendency because it is not historical.)

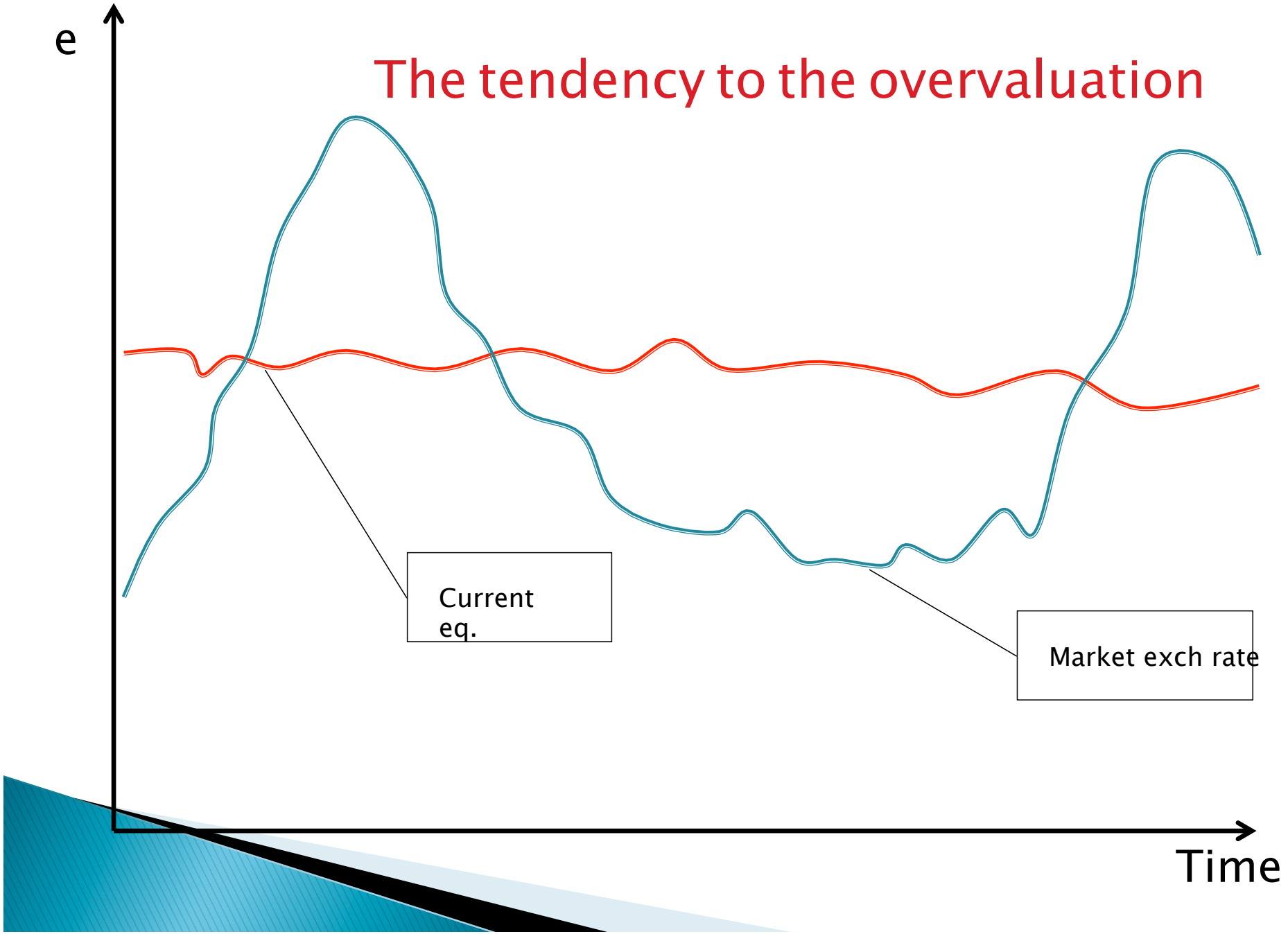
Do not mix the tendency with volatility

- Neoclassical school – smal misalignments
- Keynesian school – large misalignments
- New–developmentalism – tendency to the long–term overvaluation followd by cyclical currency crises, i.e., the volatility has a sense.
- This is the core empirical thesis of new developmentalism.

The neoclassical/Keynesian volatility and the current equilibrium



The tendency to the overvaluation



Causes of the tendency to the overvaluation

- Structural cause the Dutch disease, but it just pulls the exchange rate to the current equilibrium
- Three habitual policies, which affect the demand and supply and explain the deficits.

1. Growth with foreign borrowing ("foreign savings")
2. High level interest rate around which conduce monetary policy.
3. Exchange rate anchor policy to control inflation.

- If we add the text-book that impact on the supply and demand of foreign money (interest rate, effective demand, capital flows, capital controls, etc.), we have a complete theory of the determination of the exchange rate.

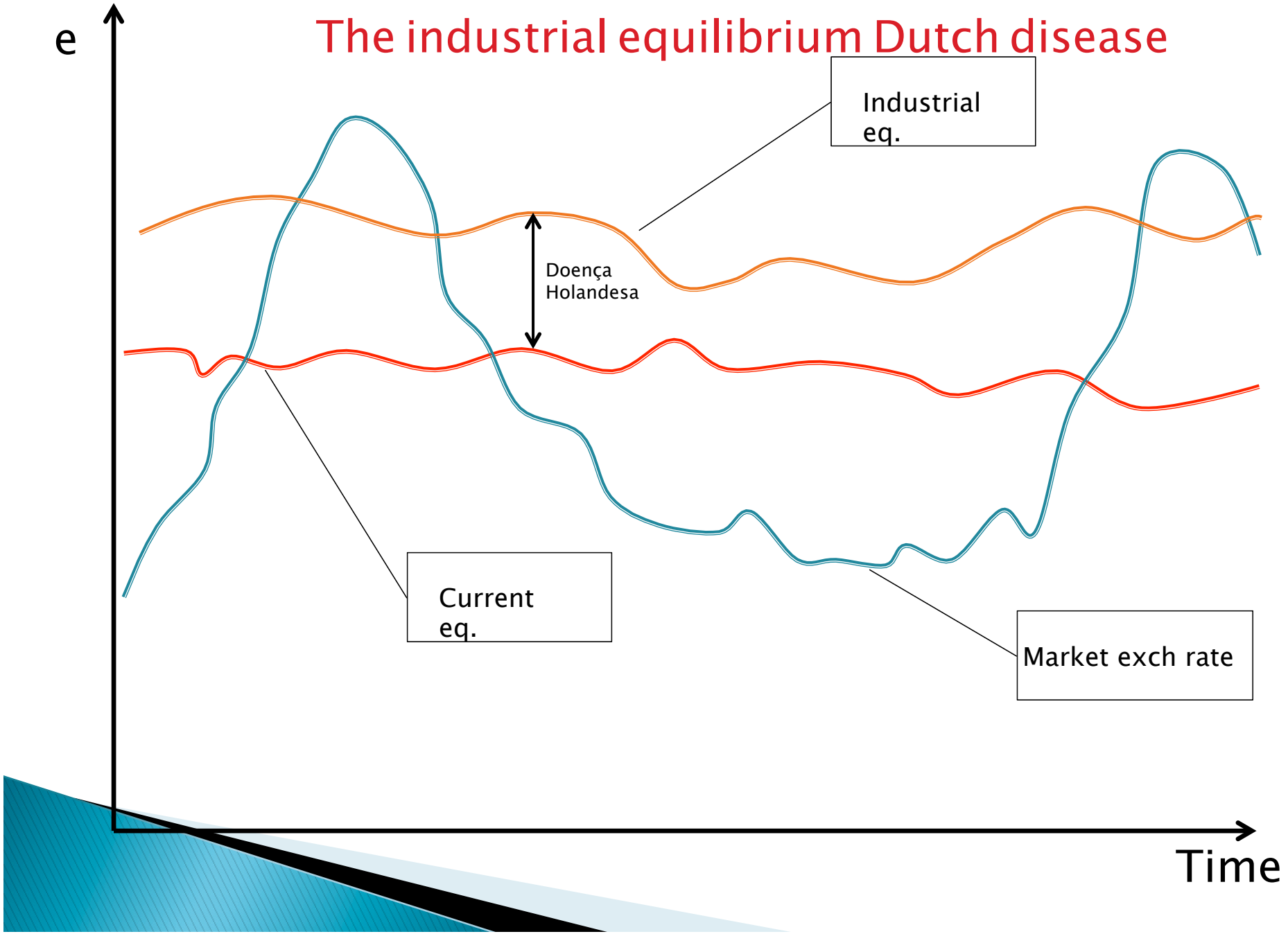
Three exchange rate equilibriums

- Current equilibrium – value that balances intertemporally the current-account. Is expresses the value of the foreign money.
- Industrial or competitive equilibrium – value that makes competitive the firms that utilize technology in the world state of the art. (Belongs to the Dutch disease model).
- Foreign debt equilibrium – exchange rate that corresponds to a current-account deficit that stabilizes the foreign debt / GDP ratio. (Belongs to the financial crisis model)

Dutch disease

- It is a long-term overvaluation of the exchange rate or a competitive disadvantage that stems from exports of commodities that, benefiting from Ricardian rents, can be exported with a profit at an exchange rate substantially more appreciated than the one required for the other tradeable firms that utilize technology in the world state of the art.
- Two equilibriums
- The commodities originating the Dutch disease define the current equilibrium, while the other competent tradable firms, the industrial equilibrium.

The industrial equilibrium Dutch disease



A value and a price of the exchange rate

- The price of the foreign money floats around the value according to the demand and supply of foreign money.
- The value of the exchange rate is the current equilibrium – is the value that cover the cost plus reasonable profit of the tradable firms that participate from the international trade and assure the equilibrium of the current account.
- In the case of Dutch disease, the exchange rate continues to be determined by the current equilibrium, but we have a second value, the industrial equilibrium, relative to the non-commodity tradable goods.

The value of the exchange rate depends on

- Changes in the comparative unit labor cost index (CULCI), which affects directly the cost of production and indirectly the current account.
1. ULC – wages / productivity
2. CULCI – compares the local ULC with a basket of ULCs of competing countries.
- Changes in the terms of trade, which affect directly the current account.

When the value or the current eq goes up, the ER depreciates

1. When CULCI goes up, and/or
2. When the terms of trade goes down

- the value increases and the exchange rate price depreciates

1. because the ER must depreciate to keep competitive the the firms and balanced the current account.

- This was what happened in Brazil recently (2014-15): the huge depreciation was caused by wages increasing more than productivity and, mainly, because the prices of the commodities fell sharply

Thus, the exchange rate is determined by

- The value of the foreign money (which includes CULCI + terms of trade), and
- The demand and supply of foreign money, which depends on:

1. The already referred three habitual policies which systematically appreciate the national currency of the developing country, and
2. Text-book variables: effective demand capital inflows and outflows, confidence, existence or not of capital controls, etc..

When there is Dutch disease

- The current equilibrium is mainly determined by the commodity prices (terms of trade), and secondarily by the CULCI of the commodities.

- The industrial equilibrium is mainly determined by the terms of trade of the non-commodity tradable goods and services.

Severity and neutralization of the Dutch disease

Severity

- It is equal to the distance between the current and the industrial equilibrium.
  - $g = (e_i - e_{c)} / e_c$

Neutralization

- An export-tax equal to the severity of the Dutch disease will neutralize it, making the current and the industrial equilibriums equal.

Exemple of Brazil

		2006-14	Today
Current equilibrium	e_c	2.90	3.50
Industrial equilibrium	e_i	3.40	3.60
Exchange rate (real)	e	2.60	3.90
Severity of the DD	$(e_i - e_c) / e_c$	17%	0.3%
Overvaluation	$(e - e_i) / e_i$	24%	-1%

Since 2010, the CULCI increases substantially, increasing the industrial equilibrium from R$ 3.40 to R$ 3.60.
In the second semester 2014, sharp fall in the price of commodities exported, increasing the current equilibrium from R$ 2.90 to R$ 3.50.
All equilibriums and exchange rates are in real terms.

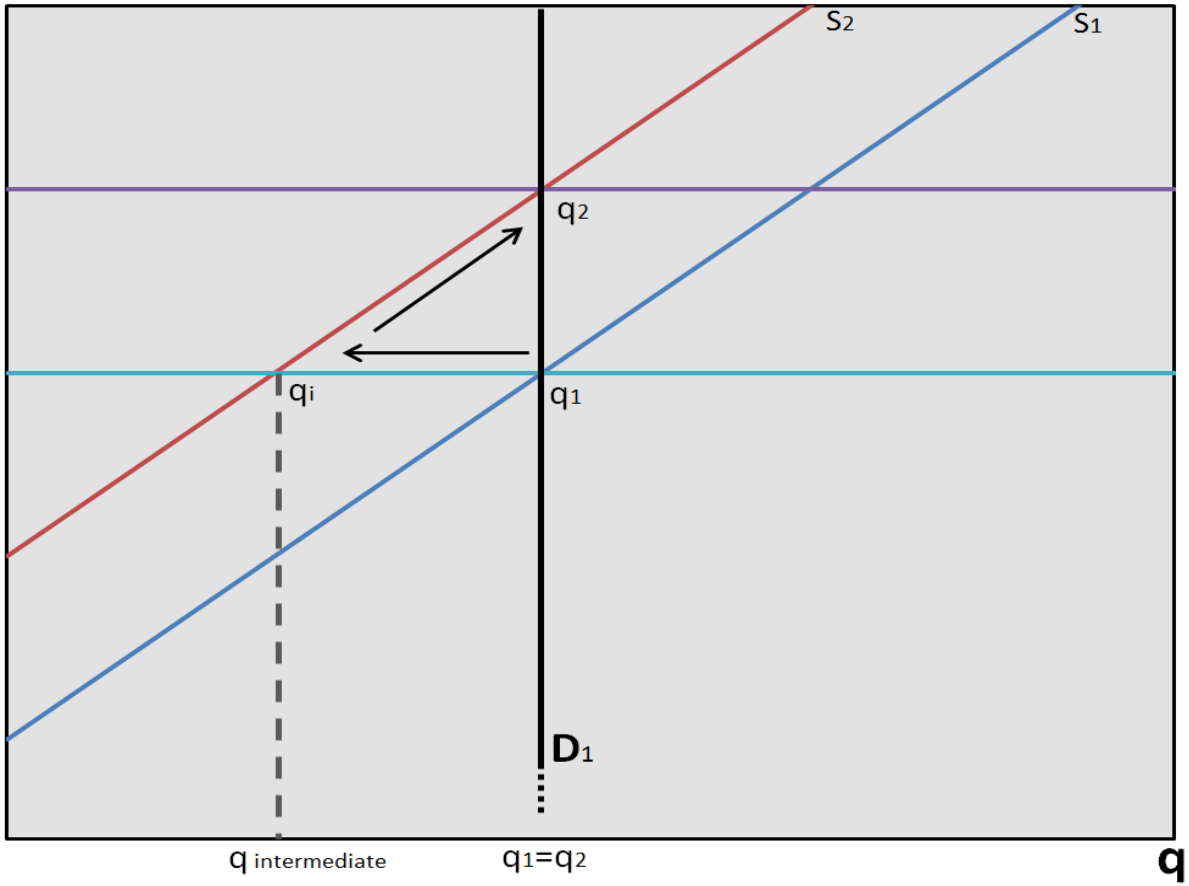
Neutralization of the Dutch disease

- A variable export-tax equal to the severity of the Dutch disease will neutralize it, making the current and the industrial equilibriums equal.
- Because:

1. Increase the value, i.e., the cost + profit.
2. Shifts the supply curve to the left.

- In the example, today the tax would be zero, between 2006-2014, would be in average, in today's prices, R$ 0.70 per US$.

Neutralization of the Dutch disease by shifting the supply curve

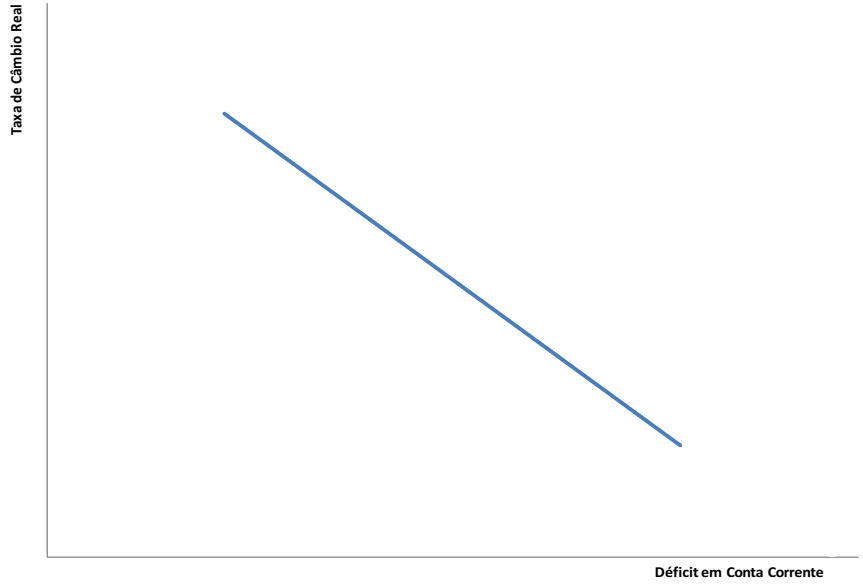


A third equilibrium: the foreign debt equilibrium

- Def: the foreign debt equilibrium is the exchange rate that corresponds to CAD in relation to GDP equal to the rate of growth of GDP.
- The foreign debt equilibrium corresponds loosely to what Williamson calls "fundamental exchange rate".
- The difference is that he (and economists in general) recommeds it, while I reject it.

Remember (when discusing alternative policies): exchange rate and the current-account

- There is an inverse and linear relation between both for each moment.
- The more valorized the exchange rate, the larger the current-account deficit, and vice-veresa.



The huge difference in recommended exchange rates

1. For new developmentalists: a competitive equilibrium consistent with current account surplus and a competitive exchange rate.
2. For the orthodoxy : the foreign debt equilibrium consistent with current account deficit and a non-competitive exchange rate.
3. For the exchange rate populists: below the foreign debt equilibrium, consistent with huge current account deficit, a highly non-competitive exchange rate, and explosive foreign debt.

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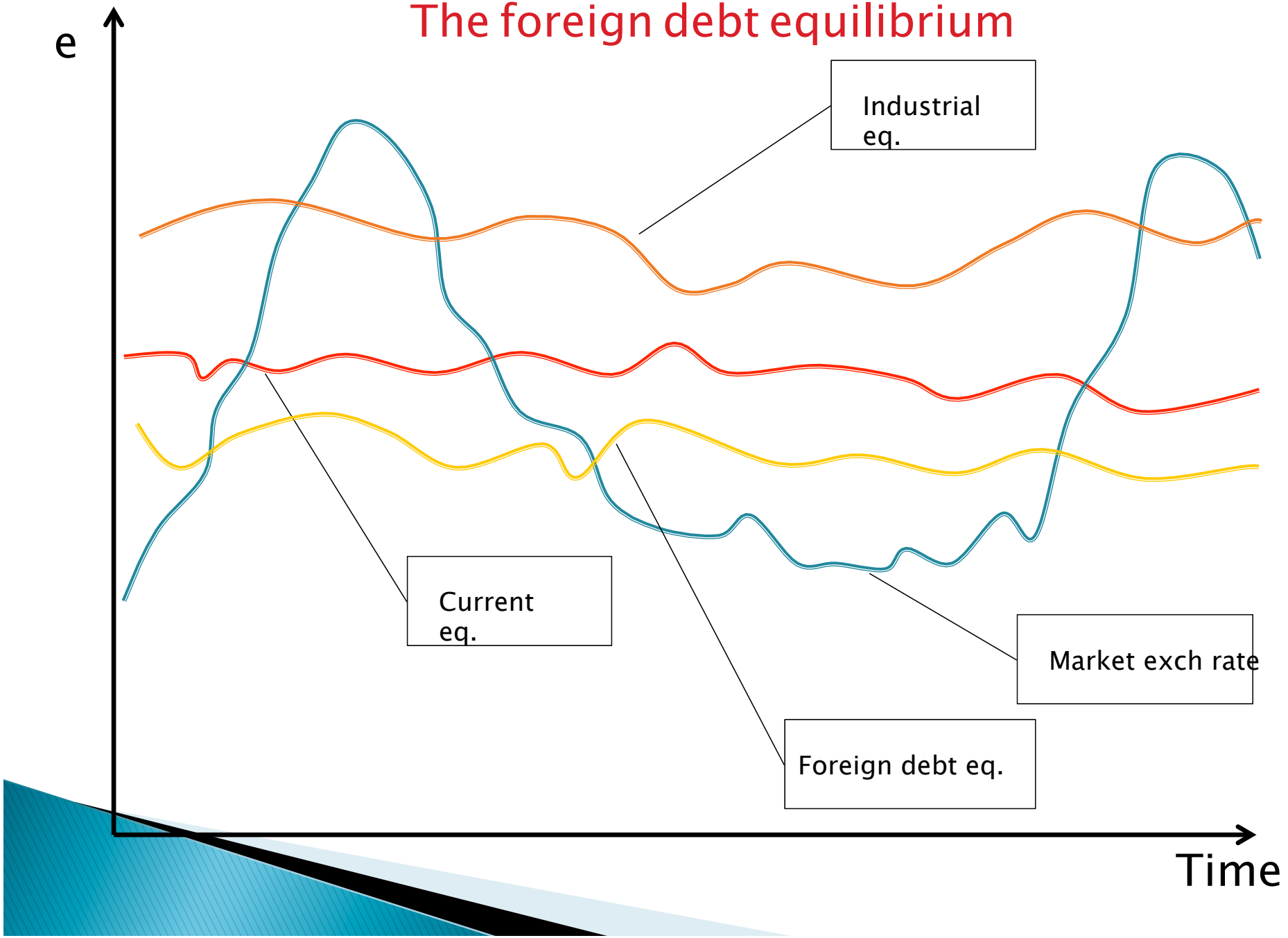
The foreign debt equilibrium



Financialization is in the core of ND

- Financial crisis are explained by the policy of growth with foreign indebtedness ("savings") rather than by budget defictits.
- They are cyclical currency crisis.
- They erupt when foreign creditors in foreign money loose confidence and stop rolling over the debt.
- They suppose a financial bubble, which explains why the exchange rate remains for years at a level that corresponds to a current account deficit superior to "foreign debt equilibrium".
- .

Exchange rate policy

ND does not have much to add add to monetary and fiscal policy, but requires exchange rate policy that performs two neutralizations:

A. To neutralize the tendency to the overvaluation of the exchange rate:

- rejecting the three habitual policies (which overvalue the exchange rate beyond the DD)

1. Growth with foreign borrowing ("savings")
2. High level interest rate
3. Exchange rate anchor policy to control inflation

- controling capital flows, when needed.

B. To neutralize the DD, by adopting exchange rate retention proportional to the international commodity prices.

Export-led growth

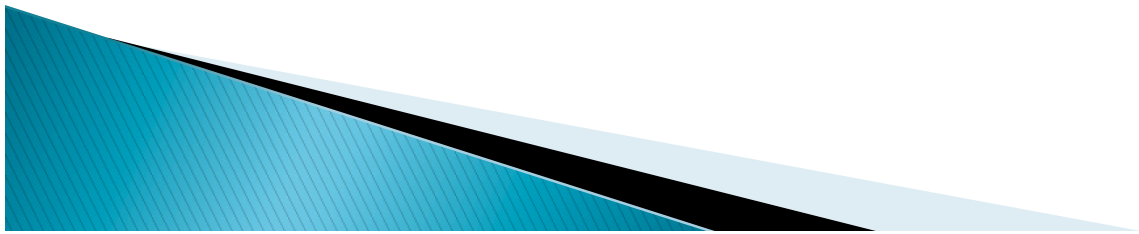
- Theoretically, growth may only be wage-led when the country is in the import substitution short phase. (But concomitantly, countries faced huge increase in inequality)
- After it, the competitive advantage of developing countries indicates export-led.
- All countries with caught up were wage-led.
- Prebisch deduced from the foreign constraint industrialization; new developmentalism deduces from it exports of manufactured goods.

Why to reject growth with foreign borrowing

- Yes, it is because, generally, foreign savings don't add to domestic savings.
- There is a high rate of substitution of foreign for domestic rates, except when the country is growing very fast and the marginal propensity to consume falls.
- Cause: when the country decides "to grow with foreign savings", it incurs in current-account deficit, the exchange rate appreciate, investiments and desencouraged, and domestic savings fall.
- Also a cause on the supply side: the appreciation increases revenues, increases consumption, domestic savings fall.

What about the distribution?

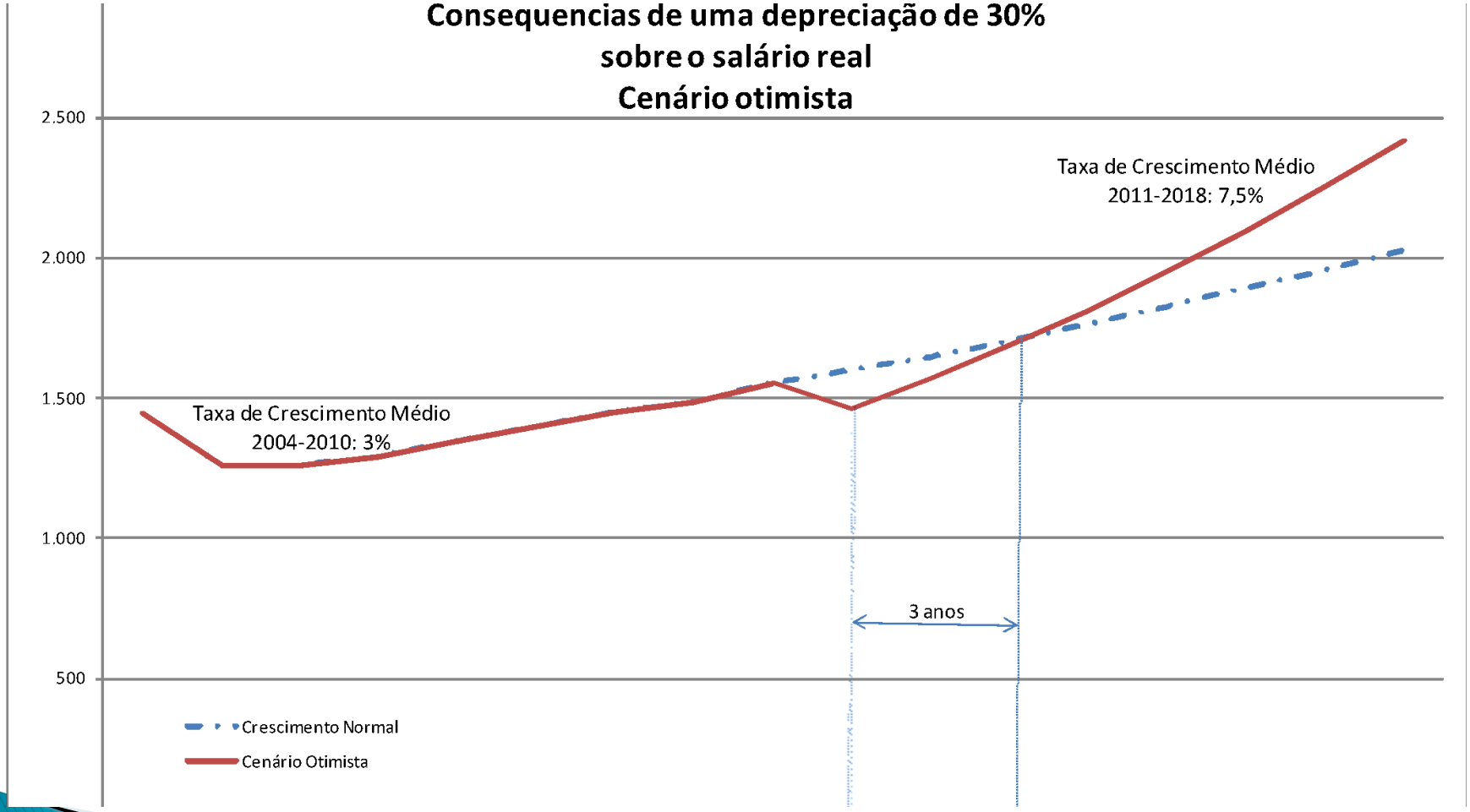
- The main object of macroeconomic policy is not distribution but full employment and growth.
- It is a huge mistake to want high wages at the cost of an appreciated currency.
- A depreciation increases profits (this is the objective) and reduces not only wages but all revenues.
- The real distributive policies:
- Minimum wage
- Expansion of the social state
- Progressive taxation.



Some economic consequences of the exchange rate policy

1. Short-term reduction of all revenues and of consumption.
2. Current-account surplus.
3. Small budget deficit.
4. Satisfactory profit rate
5. Fall of the interest rate and of the revenues of rentier capitalists.
6. Increase of the investment rate.
7. Faster growth.
8. Faster growth of wages,

Consequence of depreciation on wages



Gini coefficient before and after taxes

(mid 2000s)

	Before taxes & transfers	After taxes & transfers	Variation %
Sweden	0.49	0.23	38.8
Germany	0.44	0.28	27.3
USA	0.46	0.34	26.1

New developmentalism' internal challenge: developmental populism or vulgar Keynesianism

- Economic populism is to expend irresponsibly more than it gets:

1. the state (fiscal populism) incurring in high budget deficits, or
2. the nation-state (exchange rate populism), incurring in high current account deficits.

- Exchange rate populism is usual among liberal as well as developmental policymakers.
- Fiscal populism is usual for vulgar developmentalists or vulgar Keynesians.

Fim

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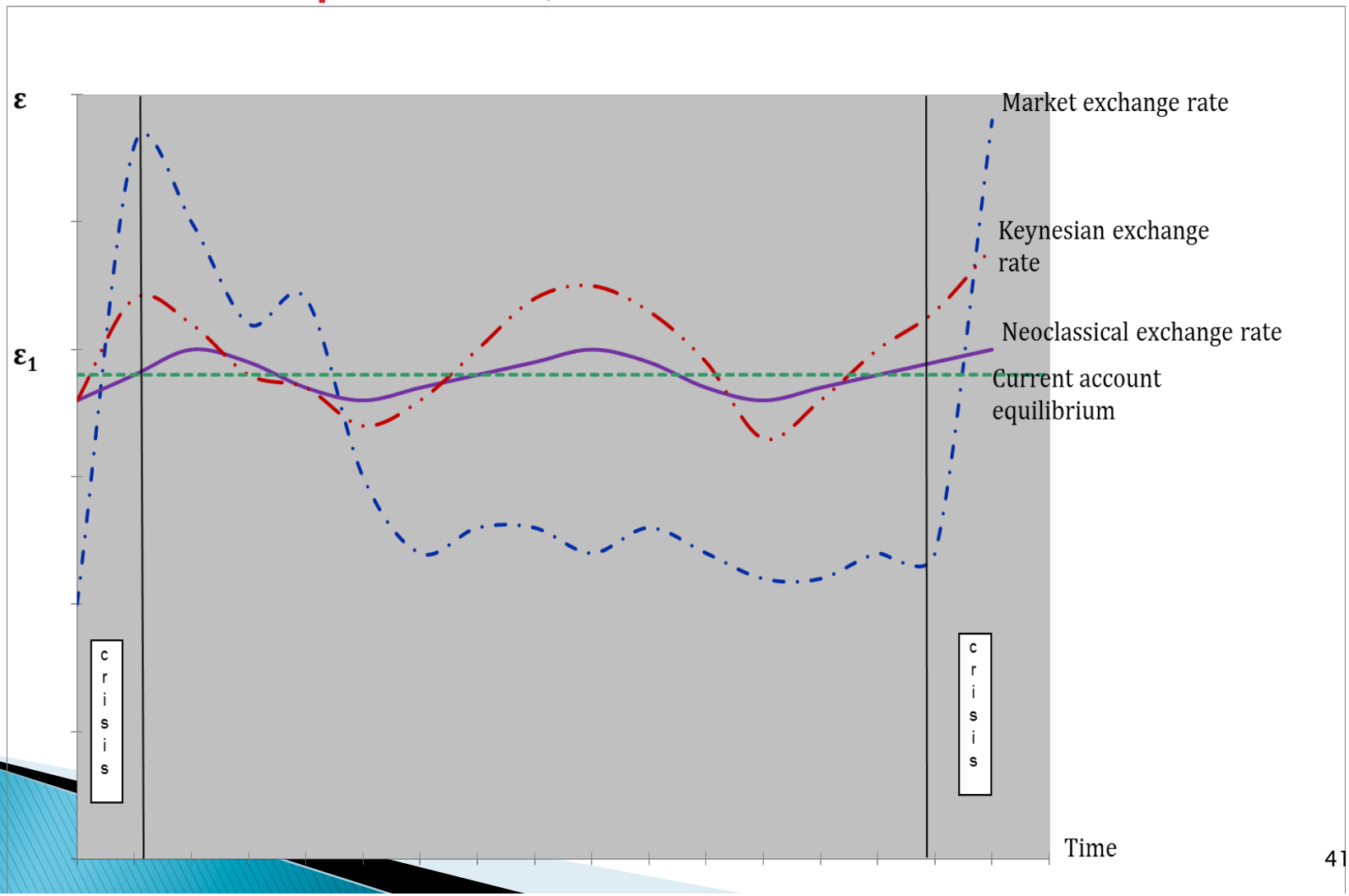
Taxa de câmbio: um equilíbrio, três teorias



Tendência à sobreapreciação crônica e cíclca da taxa de câmbio