Global unbalances between rich and middle income countries

Luiz Carlos Bresser-Pereira

EAEPE, Amesterdan,7/11/09

The center's logic since the 1950s

- In order to grow, underdeveloped countries faced a major foreign constraint: lack of capital.
- Thus, said the logic, capital rich countries should transfer their capitals to capital poor countries.
- In other words, developing countries should adopt the policy of "growth with foreign savings" (current account deficits) to be financed either by loans or by direct investments.

This logic was in contradiction…

- …with the fact that that many developing countries were growing fast since 1930 without recurring to loans or to direct investments.

But, why to bother with facts, experiences, if

- – if the "growth with foreign savings logics" said differently and seemed rational,

  – if the interests of rich countries (of their multinationals) were to have access to markets of developing countries without much reciprocity?
  - – if in rich countries multinational enterprises counted with their governments and their intellectuals to defend and legitimize their investments abroad?

1950s, 1970s, 1980s,

- In the 1950s, direct investment of multinationals in manufacturing began.
- In the 1970s, bank loans to developing countries was resumed.
- In the 1980s, a major foreign debt crisis struck the countries that believed in the growth with foreign savings – principally the Latin-American ones that believed more.
- – whereas several Asian countries did grow fast financed by with domestic savings.

In the 1990s,

- the growth with foreign strategy was sponsored by the US Treasury and IMF.
- Latin America (and 4 Asian countries) went back to foreign finance including direct investment).
- Balance of payment crises developed in Mexico, 1994; 4 Asian countries, 1997; Brazil, 1998 and 2002; Argentina, 2001
-

Since the early 2000s, world finance turned unbalanced

- fast growing middle income Asian countries and oil countries
  - are growing with high current account surpluses (or with negative foreign savings),
  - and are building large reserves and large sovereign funds,
- Whereas rich countries, particularly the US and Spain, face large current account deficits.

Why these unbalances? Why is the old logic being rejected?

- Because middle income countries are beginning to discover
- – that the old logic was false: the growth with foreign savings policy does not cause growth;

  – that, if the Dutch disease is present (as usually it does) and it is neutralized, growth must occur

  (1) with budget surplus,

  2) with <u>foreign dissavings</u>, and

  (3) with the building up of sovereign funds.

Yet, the discovery process is only beginning

- Most Latin American countries still know nothing about that, are deindustrializing and are falling behind.
- Brazil and Argentina are just beginning to realize that they must neutralize the Dutch disease and grow with foreign savings
- East European countries are today facing a major crisis because they believed that foreign savings caused growth.

Example: Brazil and the other BRICs.

- Between 1996 and 2008,
- yearly average rate of per capita growth

  - Brazil 3.0%
  - other 3 BRICs 7.1%.

Why the old logic does not hold: the overvaluation tendency

- In developing countries, there is a tendency to the overvaluation of the exchange rate that holds back investments.
- Three main causes of this tendency are
- – the mistaken growth with foreign savings policy
- – the use of the exchange rate to control inflation
- – do not neutralize the Dutch disease

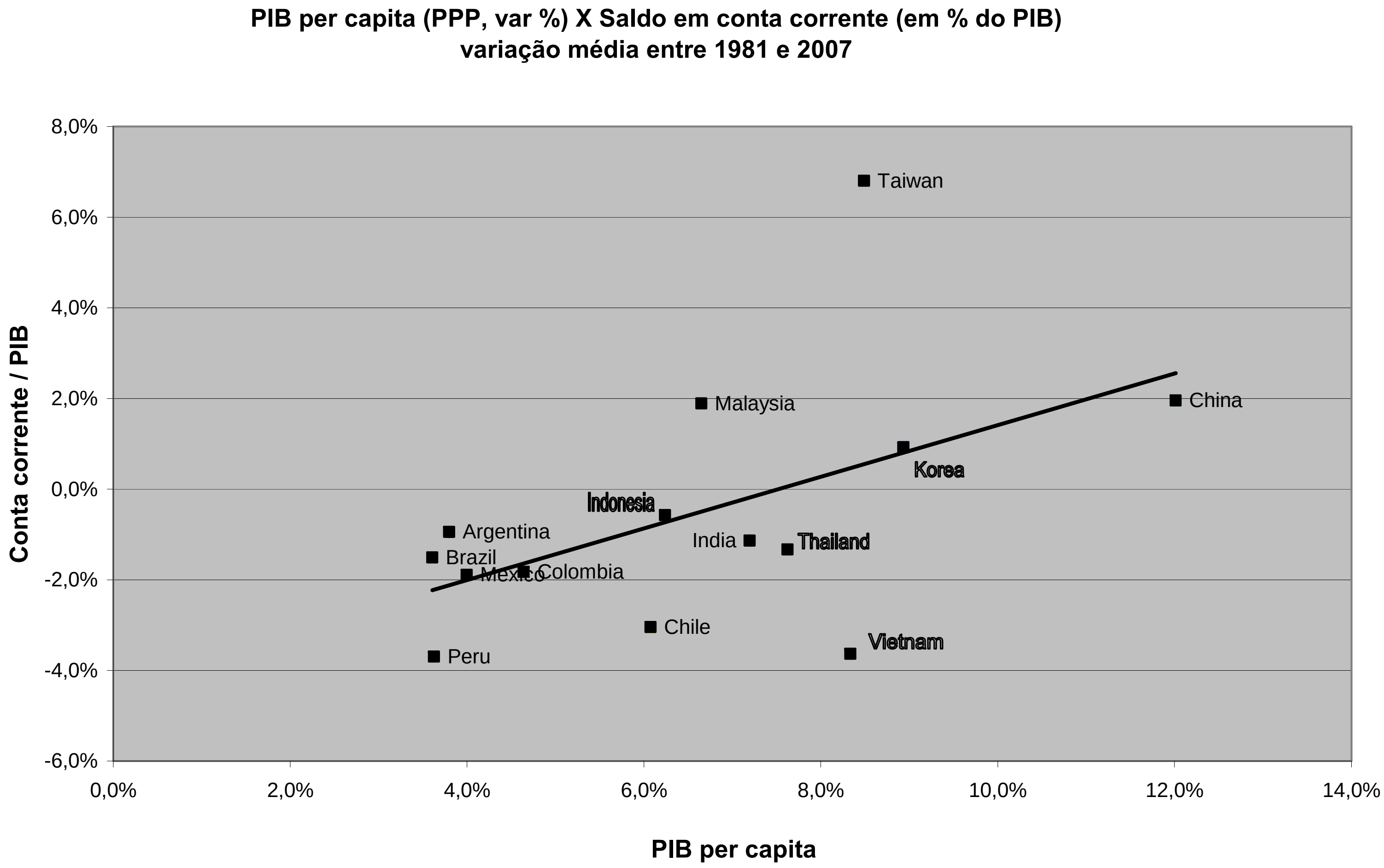
Growth with foreign savings does not cause growth

- Instead, it appreciates the exchange rate, and, in consequence,

  (1) increases artificially real wages and consumption

  (2) causes substitution of foreign for domestic savings, instead of increasing the investment rate

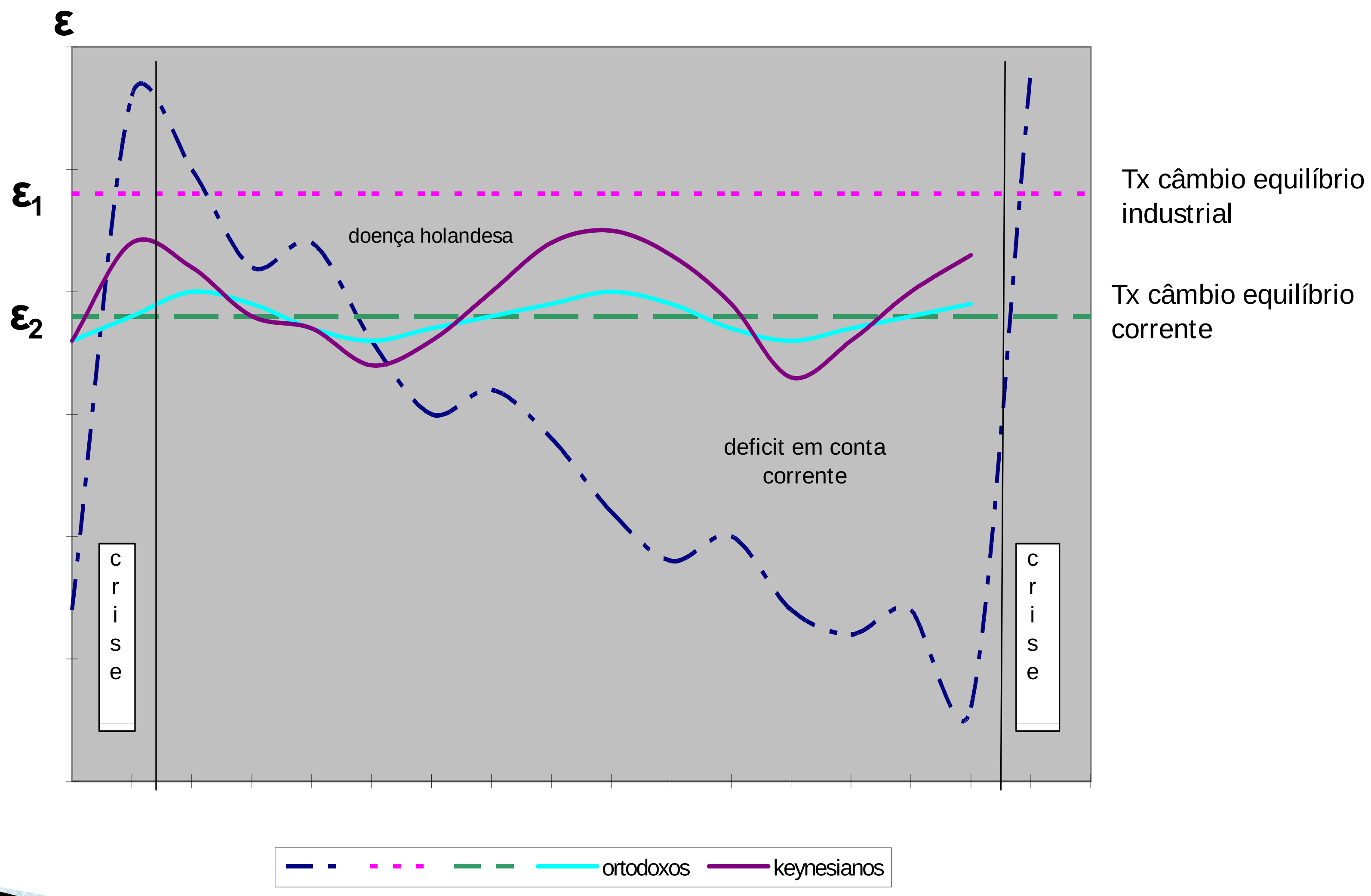
  See the following graphic: the less you recur to foreign capital, the more you grow



PIB per capita (PPP, var %) X Saldo em conta corrente (em % do PIB)
variação média entre 1981 e 2007
Conta corrente / PIB
8,0%
6,0%
4,0%
2,0%
0,0%
-2,0%
-4,0%
-6,0%
0,0%
2,0%
4,0%
6,0%
8,0%
10,0%
12,0%
14,0%
Taiwan
Malaysia
China
Korea
Indonesia
Argentina
India
Thailand
Brazil
Mexico
Colombia
Chile
Vietnam
Peru
PIB per capita

When the country faces the Dutch disease (most developing countries do)

- From mistaken, the old logics turns absurd because
- In order to grow fast, countries must neutralize the DD (or to move from the "current" to the "industrial" equilibrium exchange rate
- What means that they will necessarily experience current account surpluses (and budget surpluses)


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

In conclusion

- To the extent that developing countries are learning that the old logic was wrong and that the Dutch disease must be neutralized, we will have to live with "global unbalances", i.e., large current account surpluses in middle income countries and corresponding deficits in rich countries.

The challenge ahead:

- to find a way of combining persistent current account deficits in rich countries, with their and self-sustained growth,

whereas

developing countries catch up.