THE KEY INSTITUTION TO ECONOMIC GROWTH

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Abstract. Economic growth is almost invariably the outcome of a national development strategy. Effective economic development occurs historically when a nation is strong, and the different social classes are able to cooperate and formulate an effective strategy to promote growth and face international competition. Entrepreneurs value the protection of property rights, but they are more interested in having and taking advantage of good investment opportunities that a development strategy coordinated by government will create. A national development strategy is essentially an institution or a cluster of institutions which stimulates capital accumulation and technical progress it rise profit expectations. It works not only at the supply side or function of production side but also on the demand side by keeping the interest rate level modest, and the exchange rate, competitive.

Keywords: **strategy** **development** **economic growth** **hegemony**

In the last forty years institutions became a central concern of political scientists, and in the last twenty years, also a major research program for economists. Before that, social scientists used to adopt a structural or socio-economic approach where institutions had a role but the economic structure conditioned them, while neoclassical economists just ignored institutions. Thus, when mainstream economists focused in institutions, this was a progress; it was a way of broadening the scope of economics that had been narrowed by neoclassical economics. Yet, the form that this inclusion of institutions in development economics took place ended up being excessive and reductionist: excessive in so far as suddenly institutions gained autonomy from social structures; reductionist, because the new institutionalist economists claimed that if the rule of law, or if property rights and contracts were assured, economic development would automatically ensue from the market. In this chapter, my central concern is not to criticize this claim which frailty is self-evident, but to offer an alternative institution central that, on one hand, have a relative autonomy in relation to economic structures, and, on the other, have a key role in causing economic growth: a 'national development strategy' or a 'national competition strategy'.

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The central weakness of the new institutionalist approach to economic development derives from the fact that there is a strong correlation between the level of economic development of each society and its institutions, or, more generally, between the economic, the institutional, and the cultural instances existing in all societies. There is, for sure, some degree of freedom between these instances in so far as at certain moments the economic structure advanced more that the institutional and the cultural instances, while in others the opposite occurs. The reasonable hope that all reformers share is that second alternative is true – and sometimes is. But rarely. Usually good institutional reforms go hand and hand with, on one hand, technological and economical change, on the other, with cultural and ideological change. This fact that Marx and Engels discovered one hundred and sixty years ago has been confirmed in many ways, but few imagined that econometric studies would confirm it. Yet, this happened after institutions became fashionable among conventional economists and they decided to relate it to economic growth. What most econometric tests demonstrated is that there is a high correlation between good institutions and the *level* of economic growth, but practically no correlation between respect to property rights or contracts, or the rule of law, or even democracy, and the *rate* of economic growth. In other words, the three societal instances – economic, institutional, and cultural – are strongly in terms of outcomes (the richer countries tend also to be the more democratic, the socially more equitable, and the ones that better protect the environment) but, in the growth process we cannot find sensible correlations between institutional variables and the increase in per capita income or the improvement of standards of living. The tight correlation between the structural and the institutional instance is confirmed, while the hope that institutional reforms will cause growth is not. Institutional reforms remain essential to development, but they do not explain why some countries start growing faster than before, and gradually catch up.

What we need to find is the institutional historical fact that explains the beginning of the catching up, or, more broadly, of periods of reasonably high and sustained growth. Although what I will discuss refer to middle income countries, it applies partially to poor countries. Usually, the growth process begins when a cluster of reforms and policies that a nation is able to informally agree on open new opportunities for profitable investments, thus creating the conditions for Schumpeterian entrepreneurs invest and innovate. This new historical fact is an institution – a *national development strategy* – that creates either demand for investments oriented to the domestic market neutralizing the tendency to profits increase more than wages (due to the unlimited supply of labor prevailing in such countries) and contribute to a weak domestic demand, or keep the exchange rate competitive so as to assure that industries using technology in the state of art turn profitable despite the tendency to the overappreciation of the exchange rate. Once a country is able to agree on the cluster of formal and informal institutions that is a national development or competition strategy, it will be able to adopt the macroeconomic policies that will really make a short term difference: besides the competitive exchange rate that promote export oriented investments, and an incomes policy that keeps wages and salaries increasing with profits so as to stimulate consumption and investment, this strategy will also be austere in fiscal terms so as to keep the financial health of the state in good terms, and will keep the interest rate at a moderate level while using it to manage monetary policy.

Economic development tends to be self-sustained inasmuch as, in an environment of rapid technological change, firms have no choice but to reinvest their profits. It is, however, perennially subject to crises, low growth rates and eventual long-term quasi-stagnation, as was the case in Latin America in the 1980 and 1990s. It speeds up at times, indicating the presence of a national development strategy; at others, it becomes quasi-stagnant, because the previous strategy has become exhausted and the country was unable to replace it, or because the country got subordinated to its competitors. The challenge each nation faces in overcoming these difficult transition phases involves national autonomy and societal cohesiveness – two qualities that tend depend on many circumstances. They will be stronger in Asian countries than in the Latin American ones, because their people never thought to be 'European'; they improve after a revolution makes the country free from formal or informal international subordination as was the case of Iran; they are subdue when external domination is overwhelming as it happens in the Middle-east and in Africa for geo-political reasons – specifically for their natural resources; they are also restrained when soft ideological power coming from dominant countries persuade local elites to follow their recommended policy reforms.

In modern democracies, the state is the nation’s instrument of collective action, and the government is the body of elected officials and high-ranking bureaucrats who rules it in name of the citizens.[1] The strategic nature of economic development arises from the need and opportunity of a nation to organize efforts in order to raise living standards, and from the high correlation between economic growth and the achievement of other major political objectives. Even though development may, in the short-run, take place at the expense of social justice and environmental protection, in the medium term the positive correlation will show up because social justice and environment defenders will be empowered by economic growth. Yet, the key factor making a national growth strategy necessary is the highly competitive nature of capitalism. Today, within the framework of globalization, where commercial and technological rivalry among nations is stronger than ever, the need for a national development or competition strategy became evident. Although nation-states don't have the same cohesiveness of organizations, they also need a kind of strategic planning to succeed in international competition. In governing, a large portion of politicians' efforts and struggles is centered on how best promote the country's economic growth. On the economic relations front, in regard to trade as well as to technological and financial matters, nation-states and their business enterprises experience tough competition that requires constant initiative on the part of their governments. Nation-states also cooperate because in all cases where competitors are involved in frequent competition cooperation is necessary to define the rules of the game and to avoid conflicts damaging both sides, but, in general, competition prevails over cooperation.

In the past two centuries of capitalist development, experience shows that, when a middle income country that already completed its capitalist revolution is enjoying full growth, this is a sign that its nation is strong – that politicians, business entrepreneurs, bureaucrats and workers are operating within the framework of a loose but concerted national strategy. A nation' strength is expressed in its commitment to the political objectives of contemporary societies — security, freedom, economic development, social justice and protection of the environment — and in its ability to gather together and formulate strategies to achieve

[1] In English the term 'government' is often used synonymous with state, while 'administration' denotes what in Europe and Latin America we call government ('governo', 'gobierno', 'gouvernement'). I will use state, not government, to mean the organization that defines and enforces the law; administration or government is formed by the group of politicians and senior officials that direct the state; nation-states will be here synonyms of countries or national state; 'states', in the plural, is often used as synonym of nation-states or countries, but I will avoid that. Note also that I distinguish nation and state from nation-state: a nation or a national society plus a state and a territory form a nation-state. States, in the plural, is often used as synonym of nation-states or countries.

these objectives. Economic development tends to be facilitated by free markets that foster efficient allocation of factors of production the more developed or the more capitalist the country is, but, in developing countries, is the outcome of a deliberate endeavor of a nation to use the state as its principal institutional instrument of collective action. It is the result of an informal agreement involving entrepreneurs, workers and the middle classes with the intermediation of government. Together with governments, business associations and unions often play a major role in defining it and also in getting it put into action. Laws, policies, common understandings and shared beliefs orienting innovation and investment form this agreement that is not manifest, but can be seized up by the observer. In present times, for middle income countries, the decision to grow with domestic savings and a competent macroeconomic policy are the two key factors in this national strategy that will make the country competitively successful, i.e., catching up.

The politically oriented society that is behind a state and its government may be viewed as a civil society or a nation. When society is viewed as ‘civil society’, civil liberties are the focal point; when it is viewed as a ‘nation’, security and economic growth is the central concern. When a nation is able to agree on a national development strategy, this is a signal that this nation is strong and lively. In contrast, as Fabio Comparato (2005: A3) underlines, “when a nation no longer defines a historical horizon to be pursued with courage and hope, it enters the unhappy state of awareness that Hegel referred to: the inability to take a harmonic stance before life.”

Definition

What is a national strategy? This is not an easily answered question, as national strategies vary widely across time and space. Yet, a historical definition attempting to capture its main characteristics may be offered. A national development strategy is international competition strategy; it is a concerted economic action oriented to economic growth that has the nation as its collective actor and the state as its basic instruments of collective action. It is an informal or implied political coalition in which social classes under the leadership of the government suspend their domestic conflicts and cooperate when the problem they face is international economic competition. It is an institution or a cluster of institutions guide the main political and economic actors in their decision-making process

– politicians on how to define new public policies or reform the existing ones, businessmen, on when and where to invest. Thus, a national development strategy always involves the inducement o innovation and capital accumulation. It is a nationalist institution in so far as it establishes a clear priority to the interests of national labor, national knowledge and national capital, but the higher the stage of development, the more this nationalism will be moderate and democratic, open to international cooperation and rejecting ethnic criteria.[2]

Since people in modern world are organized in three levels – families, organizations, and nation-states – that compete and cooperate among themselves, a national development strategy is the form that each nation chooses to perform this double competition and cooperation role. Cohesive and autonomous nations will have stronger national development strategies than divided and dependent ones. The cohesiveness of a nation tends to increase with economic growth, but the process is far from being monotonic: gradual deterioration followed by crisis is common as we saw in Latin America since the 1980s. In so far as nations gain and loose cohesiveness, their national development strategies will be clear or blurred, and their economic achievements correspondingly variable.

A national development strategy is made up of a set of institutions defining economic growth’s rules of the game. Some are laws that should be relatively general and permanent expressing basic values and objectives; others are institutional reforms respond to basic changes in the social and economic structures; and still others are policies that may be more specific and temporary, defining means. Several forms of planning, starting with public investments and infrastructure investments, are an essential part of it. If they are matched with business enterprises’ strategic planning, this is a signal that a national development strategy is really in place. Yet, national development strategies or a national project must not be confused with economic planning. In most cases of successful national development strategies there has being some sort of planning, particularly in the early stages of growth when the establishment of the economic infrastructure and of heavy

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[2] Nationalism is here understood as the ideology that legitimizes the formation and consolidation of the nation-state. Citizens will be nationalists if they have no doubt that their governments are supposed to protect national capital, labor, and knowledge. According to this definition, all developed societies are nationalists – so nationalists that they can dispense the adjective and use it

industry were the order of the day. Later on, the market coordination becomes a must, and general planning will be just indicative if any.

Since the capitalist revolution began, but principally in globalization, a national development strategy is a competition strategy. It must always consider the reactions of ‘adversaries’, which will be either the other national competitors, or new facts creating obstacles to growth that demand policy change. A national development strategy is the result of a collective and informal decision making process. It is, therefore, a means to manage the national economy, to pursue alternatives capable of steering it competitively towards development. As firms plan their activities strategically, so nation-states outline national development strategies in a necessarily less systematic but, nevertheless, in effective way. Herbert Simon and Peter Simon (1979: 42) identified strategy with program, and regarded the latter as a means by which economic actors with incomplete information and limited rationality appraise alternatives and make choices, instead of permanently ‘optimizing’ as assumed by neoclassical economics. Based on the analysis of a chess match, they tell that “a program or strategy is a series of decisions carried out in a well-defined manner that enables vast economy in terms of memory and the assessment of alternatives. On defining a strategy, the player must take three principles into consideration: (1) the attacker must consider ‘strong’ games only (like checks on the opposite King)...; (2) all alternatives available to the opponent must be explored...; (3) if any of the games that the attacker is considering, regardless of how strong it may be, allows the opponent make moves in response, the attack move is abandoned for lack of promise”. It is no different with national strategies. Strategists must begin by diagnosing the situation, and then search for alternatives, always bearing in mind the fact that they cannot pursue ‘every’ alternative, but, within the framework of a program, only those that appear more promising or satisfactory. Strategists are under no illusion as to optimization, but know that they have limited time to make a decision, to choose under uncertainty. In order to implement the eventually defined strategy or program, those in charge of it will use all means available: they will write laws, adopt economic policies, they will define public investment plans and the national budget, and all sorts of other institutions; they will try to make the most of the markets’ resources, but not hesitating to intervene as needed.

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pejoratively, generally together with ‘populism’, to indicate political movements from the right or the left that oppose hegemonic global views.

When social scientists discuss models of capitalism as distinct as the Anglo-American and the corporative models, the Scandinavian and Japanese, they are also discussing the respective national growth strategies that proved effective in promoting economic development of rich countries. [3] As models or varieties of capitalism, national growth strategies are also ideal types. The difference is that models are oriented to describe and look for the interrelations between all the social, economic and political variables, while strategies concentrate in the variables that cause (or preclude) growth: a national strategy implies accelerated growth while a model of capitalism may be consistent with relatively low per capita growth rates. National growth strategies are specific to each country, but, as in the case of models of capitalism, we can devise and analyze national growth strategies that encompass several countries. Describing the East Asian model of capitalism, Ha-Joon Chang (2002b: 229) listed six characteristics that are typically traits of the respective national growth strategies. They are: "(1) the pro-investment rather than anti-inflationary macroeconomic policy; (2) the control of luxury consumption, which served both economic and political functions; (3) the strict control of foreign direct investment, which is contrary to the popular impression that these economies (except perhaps Japan) have an 'open' FDI policy; (4) the integrated pursuit of infant industry protection and export promotion; (5) the use of export as tool to exploit scale economy and, thus, to accelerate the maturation of infant industries; (6) and the productivity-oriented (as opposed to allocation-oriented) view of competition". To this list I would only add the neutralization of the tendency to the overappreciation of the exchange rate to define what I call the 'new developmentalist strategy' that I will discuss in the next chapter.

Some history

In the case of Latin America, to search for national development strategies only makes sense after 1930 when some countries that were already independent since early nineteenth century turn effectively independent and got industrialized. In the case of Asia and Africa, such search must be made after World War II, when these countries become

[3] There is already a large and competent literature on models of capitalism. See, among others, Schmitter (1974), Esping-Andersen (1990), Albert (1991), Goodin et al. (1999), Hall and Soskice (2001), Robert Boyer and Pierre-François Souyri, eds. (2001), Huber, ed. (2002), Stephens (2002).

formally and, in most cases, substantively independent (it is the case of the dynamic Asian countries). For the Latin American countries, the great depression of the 1930s creates an opportunity to begin or boost industrialization. The national revolution, which began formally more than a century before with the political independence, then gets moving. In Brazil, in Mexico, and, at a lesser degree, in other Latin-American countries, a national-developmentalist strategy based in import substitution and state intervention attempted to emulate and adapt the experience of late-development central countries such as Germany and Japan. Aiming to neutralize the Dutch disease or more broadly the tendency to the overappreciation of the exchange rate (that economists did not known at that time but policymakers had an intuition on it) countries used multiple exchange rates that caused the transference of income from export agriculture and mining to industrial firms. Countries also resorted to several forms of planning and industrial policy to stimulate investment in higher per capita value added industries. Between 1930 and 1980, national-developmentalism was successful in Latin-America.

At first, these national development strategies used local resources to finance development. This was the right thing to be done since it avoided the appreciation of the local currency and the loss of competitiveness of local industries that is inevitable when capital inflows are bigger than the demand for hard currency. However, since the early 1970s, given the assumption that ‘rich countries are supposed to transfer capital to capital poor countries’, they increasingly resorted to foreign loans and to direct investment, while maintaining the protectionist strategy and preserving pessimism towards exports of manufactures that no longer made sense. These two mistakes lead to a great crisis in the early 1980s, which Latin-America countries have yet to fully overcome. Since around 1990, out of their own national fragility and responding to the increased ideological pressure coming from the North – the neo-liberal wave –, Latin American countries fell back to the condition of quasi-colonies, and their elites accepted an imported strategy – conventional orthodoxy – which rather neutralizes than promotes economic development.

In contrast, some Asian countries that remained subject to European imperialism until World War Two, gained autonomy at that moment.[4] Some of them, like Korea and Taiwan,

[4] Japan was never a colony, and this was one of the reasons why it was the first Asian country to be part of the center. China also was not a formal colony but fell under foreign rule after the loss of

underwent in the 1950s agrarian reform. At first they used an import substitution strategy, but, whether because their natural resources were limited, or because their elites, being indigenous instead of transplanted from Europe, were better able to state their national interests, they changed to an export-led strategy as early as the 1960s, while keeping industrial policies. Japan's successful economic growth served as model for them. It is the 'flying geese strategy' that is beginning, where countries acquired the conditions for development in successive waves: first was Japan, in the 1950s; Korea, Taiwan, Hong Kong and Singapore follow in the 1970; third, in the 1980s, come Malaysia, Thailand, Indonesia; forth, in the 1990s, China; and, in the 1990s India and Vietnam. In all of those countries, the more strategic macroeconomic price – the exchange rate – was deliberately kept competitive, and industrial policies were markedly active while tariff protection was gradually reduced. By practicing competent macroeconomic policies that kept state finances sound, limited finance with foreign savings, and managed exchange rate, they avoided the 1980s foreign debt crisis (that paralyzed development in Latin America) and kept their economies competitive and growing.[5]

The dynamic Asian countries, with their manufactured goods export-led strategy, had crucial advantages over Latin-American countries: the first Asian tigers were small and soon changed from import substitution to export led growth; many underwent agrarian reforms that assured an evener income distribution; they always adopt strict fiscal policies; they practically avoided the great 1980s foreign debt crisis by limiting foreign indebtedness or the growth with foreign savings policy; they kept limits to foreign investment; their Dutch disease was much weaker than in Latin America if any. All this permitted them to keep their exchange rate competitive. In the 1980s, while Latin American were immerse in debt crisis and economic populism (a perverse and non-predicted outcome of the transition to democracy or a reaction against the military regimes policies that happened in this decade in several Latin American countries) Asian countries were making their transition from the first to second stage of economic growth, or from old national-developmentalism to new developmentalism.

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the Opium War. India was a colony, and for that reason lost even more than China in the nineteenth century.

[5] As we will in Chapter 5, although the growth with foreign savings policy is usually negative to economic growth, in periods of high growth it may be positive.

What explains this difference of behavior between the Latin American and the fast growing Asian countries? Why the Latin American elites surrendered to the North while the Asian did not? One explanation for this greater national autonomy of the Asian countries may lie in the fact that they were submitted to industrial imperialism in the nineteenth century, but, except for the Philippines, their elites remained native, whereas the elites in Latin American countries, albeit of mixed race, consider themselves as Europeans, and, probably because of that, had always had more problem identifying as national elites. Thus, probably it is not by chance that, among the Asian countries, the Philippines presents also dismal growth rates.

Supply and demand side

National development strategies will vary from moment to moment, and from country to country. Two countries that in the last 20 years experienced national development strategies – China and Ireland – could not be more different. Yet national development strategies have certain common traits that are related to concept of economic development and its causes. On the supply side, economic development results of the increase in productivity caused by capital accumulation with the incorporation of technological knowledge, from investments in the infrastructure that have positive externalities, from entrepreneurs innovations, from the transference of manpower from the production of goods and services involving higher per capita value added. Still on the supply side, economic growth depends on technological progress and innovation, on education, food, and health care, or, more broadly, on human capital. On the demand side, economic growth depends on the elements that compose effective demand: investment, consumption, state expenditures, and exports minus imports. When demand is sustained, entrepreneurs will face investment opportunities to use the existing recourses created on the supply side. To identify if a country has a national strategy or not we are supposed to look not only to its main outcome – GDP growth per capita – but also if the main characteristics on the supply and on the demand sides of economic development are present.

On the supply side, all development strategies require or suppose a financial system to finance investment or capital accumulation. In poor countries, in the early phases of development, when the country is beginning its capitalist revolution, finance is obtained through ‘forced savings’ originated in the state, through profits realized in some primary goods industry using natural resources in which the country is rich, and through foreign investment. The essential task is to profit from the positive externalities caused by state and foreign investment (Rosenstein-Rodan 1943's big push model), and to transfer manpower from traditional activities to capitalist ones (Lewis 1954's model). The existence of a primary goods industry using local natural resources from which the country is able to collect Ricardian rates is a standard form of initiating capitalist development that will be as much effective as the state is able to tax such rents thus neutralizing the Dutch disease, and using the resources to finance its own investments and increase social expenditures. As industrialization takes place, or the industrial revolution is completed, the reinvestment of profits will tend to become the main source of finance to investment. On the other hand, the private and the state financial system develop, and become capable of investment finance. The main agents of the accumulation process are business entrepreneurs, but in the first stages of development, the state plays a strategic role in promoting forced savings either through the creation of social security funds, or through taxes, or through investment banks.

A second trait of national development strategies is informal planning and industrial policy. Liberals reject both, but all countries used them, particularly in the first stages of growth. National development strategies involve channeling idle funds or funds originated from forced savings towards public investment or business firms for investment by means of incentives or subsidies. In almost every country, the state played an important role in the creation of the basic infrastructure of the economy and in increasing the rate of capital accumulation from around 5 to more than 20% of GDP. Yet, as the economy's complexity and diversity increase, forced savings cease to be required while industrial policy looses relative significance as markets assume a larger role in resource allocation. As shown by Gerschenkron (1962), in the early stages of growth of backward central countries, the state played a decisive role in causing capital accumulation and growth. Yet, after some time, as the national economies gain in complexity, markets assume the coordinating role. In the transition from one to the other mode of development, a crisis will usually turn out, after which the nation will have to devise a new national development strategy in which the role of markets and entrepreneurs increase. In any circumstance, the state will conserve its capacity to achieve public savings to finance the always required and strategic public investments. In this second stage, national growth strategies will develop a national financial system able to finance investment and technological progress. It will also continue to get involved in industrial policy despite conventional orthodoxy condemnation of it. It could not be different, since globalization made the nation-states more interdependent but not less relevant as is usual to hear; on the contrary, globalization made them more strategic, since it is characterized by an acute competition among nation states through their business enterprises.

A third common trait of national development strategies are policies connected with public education, health care, science and technology. All economic development theories emphasize human capital and technical progress, where the role of state agencies is strategic, but the business enterprises are supposed to have an increasing responsibility. Innovation lies, naturally, in the hands of business entrepreneurs – be them the classical individual entrepreneurs, or the executive entrepreneurs. A forth canonical trait of national development strategies on the supply side are state investments in the infrastructure, principally in energy, transportation, and communications. The state-owned enterprises, many of which were privatized in the 1990s, are the best example of such characteristic.

Fifth, a national development strategy is usually involved in making the state organization or public administration effective and efficient, so as it may be a tool for development. Public service reforms that in developed countries happened in the nineteenth century are the classical reforms in this area. In England, France and the United States, however, they happened after industrialization happened. Many Latin American countries between the 1930s and the 1970s, and several Asian countries since 1950 adopted 'developmentalist public administration reforms' aiming to make their bureaucracies flexible and modern enough. Finally, since the 1980s many developed countries, and since the 1990s, some middle income countries, responding to the growth of the Social State or Welfare State, are getting involved in managerial or public management reforms to make public services more efficient.[6]

These five common traits are on the supply side of economic growth. Yet, many developing countries have unused specialized labor, including highly educated people, that migrate to rich countries for lack of internal demand. Or have capable entrepreneurs that are unable to innovate and invest for lack of demand, or, in other words, for lack of investment opportunities. That is why in every national development strategy a central characteristic is its capacity to ensure a strong aggregate demand. How they do that? Usually, Keynesian economists underline the need fiscal and monetary policy to increase investment and consumption. This is OK, but the limits of such policies are well-known: fiscal policy must be temporary because fiscal balance is a condition for state capability; monetary policy is also a short term anti-cyclical policy, not a development policy; careless policies in these two areas may cause inflation instead of growth. To have a competent macroeconomic policy, that assures in the long run moderate interest rates and competitive exchange rate, is a condition for growth, but in this domestic arena the policymaker is permanently constrained by tight checks. He must principally keep the public deficit and the public debt under control to keep the state capable – an effective instrument of collective action.

There is, however, a form of effective demand that is less constrained economically. I refer to exports. Strong export increases are a major development factor on the demand side. If the country has, on the supply side, efficient productive capacity, the key problems turns the exchange rate: it is necessary to have a competitive one in order to have an export-led growth strategy. For some time, in the beginning of the process, the country may resort to import substitution, but economies of scale establish definite limits to this alternative, while there is no limit to an export strategy except the domestic ones: its productive and technological capacity. That is why all countries that grow strongly are able to keep the exchange rate and keep it competitive. For that, the main problem that national development strategies are supposed to solve is how to neutralize the tendency to the overappreciation of the exchange rate. I will discuss this problem in the last two chapters of this book. It is related to the Dutch disease, the growth with foreign savings policy, and with exchange rate populism.

In order to cope with the Dutch disease and the wild capital inflows, or to keep its exchange rate competitive, the country is supposed to manage it. For long developing countries did that indirectly through complex systems of tariff protection and export subsidies. In consequence, the resulting effective exchange rate was more depreciated than

[6] I work extensively on this subject since 1995, when I was Minister of Federal Administration and Reform of the State, and developed a model of public management

the nominal exchange rate.[7] Today, when such practices are not anymore compatible with the complexities of the industrial economies of developing countries, the exchange rate is being managed more directly and more market friendly through the imposition of export taxes on the commodities causing the disease, through purchase of foreign currencies and the build up of international reserves, and, when these measures are not enough, through the adoption of controls to capital inflows. This was what Latin America did up to the 1980s, and what the Asian fast growing countries do up to the present.

The key institution

It is easier to understand the role of national development strategies in development if we view them as the key institution in economic growth. In societies where the modern nation rose as the central political actor, and the state is the main instrument of collective action, a national development strategy is the institution or collection of associated institutions to achieve economic growth. It is a cluster of laws, policies, agreements, understandings, and shared beliefs – i.e., of formal and informal institutions – that create investment opportunities and orient competitive economic actions undertaken on one hand by business entrepreneurs, workers, and the professional middle-class, and, on the other, of politicians and state bureaucrats.

Since Douglass North (1990) wrote his book on institutions aiming to make neoliberal economics broadly consistent with institutional analysis, and won a Nobel Prize, institutions became again fashionable in economics. Classical, Marxist, German historicists, and principally the American institutionalists had always attributed a central role to institutions, while neoclassical economics practically ignored them for around a century. When, in the early 1990s, institutions were eventually brought back to mainstream economics, many hailed this as good news. Yet, this institutions' 'revival' did not open the horizons of economic analysis nor turn it more realistic because it took a reductionist approach: growth would take place in a country whenever one institution was present: the guarantee of property rights and contracts. In this way, the new

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reform (Bresser-Pereira 2004).

[7] Look that 'nominal' here is not opposite to 'real' (inflation controlled) but to 'effective' exchange rate (implicit after protection and export subsidies).

institutionalists were just repeating the old *laissez faire* or the new neo-liberal saying that the crucial condition to economic growth is that society assures the well functioning of markets.

This view is not empirical – it does not correspond to historical reality – but ideological. First, because the protection of property rights and contracts or, more broadly, the rule of law is a consequence rather than a condition to economic development. The Liberal State that emerged in England, France and the United States in the early nineteenth century and assured the rule of law did not preceded but coincided and followed the respective industrial revolutions. Second, in capitalist development, the protection of property rights and contracts is a relevant but not a sufficient condition, nor the more important condition. Entrepreneurs are not either bureaucrats or inactive rentiers that prize security over all things, but risk-taking agents aiming for profits and self-achievement; they are interested in security, but they are much more interested in monopolist profits derived from innovation and in the expansion of their enterprises. Growth oriented institutions may sometimes not guarantee property rights and contracts, but offer excellent investment opportunities. In China, national and foreign firms invested and are investing so much and the country is growing so extraordinarily not because Chinese institutions guarantee property rights (only recently they are beginning to do that), but because there is national development strategy in place that, combined with high rates of growth, offers to entrepreneurs extraordinary opportunities of realizing profits and expanding their enterprises.

Instead of the protection of property rights and contracts, my claim is that a national development strategy is the key institution for fast and sustained growth. While a country cannot from a day to the other, protect property rights and contracts or the rule of law because this achievement depends on a long and difficult economic and political process, their people have shown that, in certain moments they are able to develop a national growth strategy. This will happen principally when the people realizes that it is either backward in relation to its competitors or that it is being dominated by foreign powers. The former was the classical motivation for Germany, in the second part of the nineteenth century, have unified; the later has many examples, but probably the most telling is the one of China, that was a major empire up to the eighteenth century, came on foreign dominion in the nineteenth and in the first part of the twentieth century, but since 1949 adopted a national development strategies – first adopting a statist strategy (that Chinese called 'socialist', but was really the radical version of other statist early industrializations like the one of Japan or, at a lesser extent, of Brazil), and later, an overtly capitalist one.

Marx regarded economic development as a process where institutions change at a slower pace than economic and technological infrastructure, so that they eventually face a revolutionary updating process. Thus, he viewed institutions as an obstacle rather than an incentive to development. During the twentieth century, however, as nations learned how to devise and implement national development strategies using their state, the more capable the state became, the more institutions beginning with national development strategies became an effective and positive social tool. Marx, living in the times of the liberal but not yet of the democratic state (which would only arise in the twentieth century) did not see the state as an instrument of democratic collective action, but just as an instrument of political domination. Even at that time, however, the state was already being the nations' main instrument for promoting economic growth. In the time of globalization, despite the neo-liberal attempts to diminish the size and intervention capacity of the state organization, his active responsibility for advancing economic growth was eventually enhanced as the completion among nation-states got tougher.

Historically the forms of state intervention and national growth strategies depended on the stage of economic growth of each individual country, and on the model of capitalism that it adopts. In all circumstances, the state was an effective instrument in so far as the government was able to lead a national agreement. Such agreement did not eliminate domestic class conflicts, but showed that such conflicts were not strong enough to prevent the nation to get together when the problem was to compete internationally. Besides being an organization that guarantees the law, the state is the law system itself; thus it both an organizational and a normative institution – the constitutional matrix of the other formal institutions. When this complex organizational system institution gets dynamic, when the officials that form it (politicians and bureaucrats) get embedded in society oriented to promote hard work, innovation and investment, the correspondent normative institutional system will be also dynamic and forward looking – and we will realize to be in the presence of a national development strategy. The guarantee of property rights and contracts is only one of the institutional aspects and not necessarily the more important of this strategy.

If it is true that national development strategies do not suppose overarching planning experiences, it is also true that those responsible for the strategy will not count with self-regulated markets capable of allocating resources. According to the new institutionalist assumption, the market is the default form of production coordination, while organizations and institutions are second-best means for such coordination that become necessary when transaction costs are too high. This kind of reasoning is alien to the actual assumptions behind successful national development strategies. According to neoclassical economists' assumption that, in order to start drawing a strategy, the policymaker part from a general equilibrium situation, and, then, abandons successively the assumptions that are not realistic, to, finally, , to arrive to the reality of the country's economic and political system. Instead, the pragmatic policymaker parts from the existing mixed reality and from an open macroeconomic model that must be constantly adapted and updated, to exam the clout of the strategic macroeconomic variables: exchange rate, interest rate, public deficit, public savings, current account, etc. Equally alien to the pragmatic policymaker participating form a national development strategy is the statist assumption that the state should be able to manage or plan the entire economy. National development strategies are always pragmatic institutions that arise from social practice and, therefore, cannot be driven by ideological dogmatisms, whether being interventionist or neo-liberal. The market is an extraordinary institution for resources allocation, but, as Polanyi (1944) remarked, it is just one of the institutions existing in a given society, and it is intrinsically limited in its capacity to coordinate the economic system. Similar constraints limit state intervention. Thus, national development strategies imply viewing the state and the market not as competitors but as complementary institutions that a national growth strategy is supposed to make the best use of.

Summing up, national development strategies differ, depending on the stage of growth and the model of capitalism. At the early development stages, the two main strategies countries adopt to develop are forced savings and protection of the infant industry; at later stages, they resort to dynamic macroeconomic policies that maintain the fiscal budget in long term balance, keep the exchange rate competitive neutralizing the tendency to the overappreciation of the exchange rate, assure a clear differential between a satisfactory expected profit rate and a low interest rate, allow for wages and salaries to increase with productivity, and involves stable prices and reasonable full employment.

In the short term, national development strategies promote capital accumulation and technical progress by achieving a dynamic macroeconomic stability that includes full employment. Additionally, it involves industrial policies stimulating or protecting high per capita value added industries. Differently, however, from what happened in the times of old national-developmentalism, in new developmentalism industrial policies and tariff protection are less important than market friendly competent macroeconomic policies which necessarily involve a competitive exchange rate. In the 1950s, when the manufacturing sector was an infant industry, the assumption was that developing countries would not be able to compete in this area. Yet, manufacturing industry soon ceased to be infant, and since the 1970s the countries that adopted an export led strategy became major exporters of manufactures. Yet, the exchange rate remained an essential problem. While developing countries' policymakers were not aware of the Dutch disease and of the growth with foreign savings policy as the main causes of the tendency to the overappreciation of the exchange rate, they adopt confused policies that in some cases were effective and caused growth. Now, they begin to be more consistent in their policies aiming to guarantee a competitive exchange rate.

National development strategies involve the participation of different social classes in the nation. Thus, it implies class negotiations where government is supposed to play an intermediary role. At the same time, the strategy must be able to provide more profits to business entrepreneurs, higher wages and salaries for the workers and the professional middle class – something that can only be achieved if growth or increase in productivity is taking place. One of the central reasons why capitalism remains the only alternative of social economic organizations is increased in productivity may be shared by workers and the professional middle class without reducing the profit rate (Bresser-Pereira 1986). If labor negotiations do not count with growth, they either turn into aggressive behavior among the classes or into loss of societal cohesiveness or anomy. The more democratic and economically advanced is a country, more attention to equality of opportunities and political freedom will be required from the strategy. In a developed country where social and democratic values are better entrenched, the social justice and the democratic constraints will be stronger than in developing countries, but in none they can be ignored. National development strategies involve political agreements, and politics implies always argument and compromise to create new institutions – to develop new and better rules of the game.

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