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Luiz Carlos Bresser-Pereira
Carmem Feijó
Eliane Cristina de Araújo

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Do liberal policy regimes condemn Latin America to quasi-stagnation?

Luiz Carlos Bresser-Pereira, Carmem Feijó, and Eliane Cristina de Araújo

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Abstract. Police regimes are incompatible with economic growth because liberal economists don't see industrialization as a condition for economic development; because they pressed for trade liberalization, ignoring that the import tariffs were a way of neutralizing the Dutch disease; beause they don't see that the growth with foreign indebtedness policy as well as the use of the exchange rate as an anchor to control inflation harm growth because the required capital inflows to finance the respective current account deficits appreciate the national currency, and, so, stimulate consumption while discourages investment; because the austerity programs that they defend are rather a way of defending the interests of rentiers and financiers than a sound macroeconomic policy.

Key words. Liberal regimes, developmental regimes, foreign constraint, current account deficits, exchange rate

JEL classification. B5, E0, O1, P0

Introduction

Latin American countries are quasi-stagnant since 1980. The 1980s and the 2010s were lost decades; the growth between them, feeble. At the root of the regional turmoil is economic failure. Latin America is deindustrializing, experiencing quasi-stagnation, and falling behind for 40 years, while the East Asian countries that began to grow after the Second World War are today rich or turning rich countries. There are many causes on the supply side why Latin-America have been quasi-stagnant from the 1980s, while East Asian countries, although undergoing some reduction in their growth rates, have continued to grow fast. Among these causes the priority given to education and economic inequality are the more mentioned. They are real problems; they explain while from 1950 to 1980 East Asian tigers were already growing a little faster than the Latin-American countries, but they do not explain why from the 1980s Latin America became quasi-stagnant. The main reason is that around 1990 Latin America fully adopted the neoliberal reforms, while the East Asian countries, although also opening their economies, did that in a more limited and cautious way. In a recent paper, Bresser-Pereira, Araújo and Peres compared the two groups of countries and argued that the "liberalization trap" (not the "middle-income country trap") was this historical new fact.[1]

The relative stagnation of the region may be shown by comparing the growth of the GDP per capita from 1980 to 2018 in the region with the growth in the rich countries, and in the East

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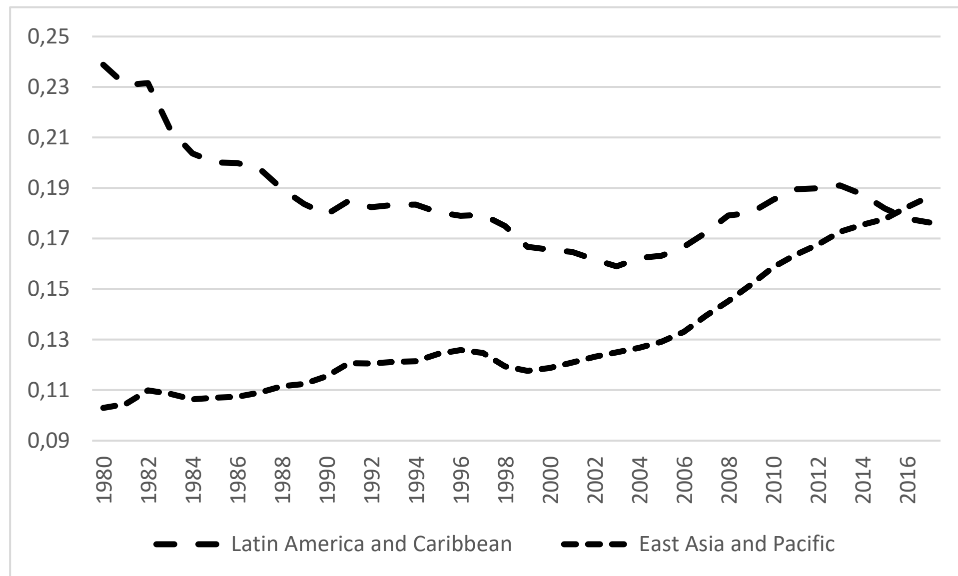
Luiz Carlos Bresser-Pereira is emeritus professor of Getúlio Vargas Foundation, bresserpereira@gmail.com; Carmem Feijó is professor of economics of Universidade Federal Fluminense, cbfeijo@gmail.com; Eliane Cristina Araújo is professor of economics of State University of Maringá, elianedearaujo@gmail.com.

Asian countries. In Figure 1, where the GDP per capita of the United States in these 40 years are 100% and the lines show the evolution of the GDP per capita in this period in the East Asian and Pacif countries and in Latin America and Caribbean as a percentage of the American, we see graphically this falling behind.

Figure 1: GDP per capita of Latin America and Caribbean and East Asia and Pacific in relation to the GDP per capita USA (constant 2010 US$): 1980-2018



Source: World Development Indicators.

Policy regimes – the way capitalist economies are organized – are either developmental or liberal.[2] The policy regime is developmental when it involves a moderate intervention of the state in the economy and a national perspective; it is liberal when such intervention is limited to the minimum. In Latin America and East Asia the policy regime changed from developmental to liberal in the late 1980s. This represented a radical change in Latin America, while it was milder in East Asia, which did not had the Dutch disease problem, and were already open economies exporting manufactured goods. Considering the last 40 years of quasi-stagnation, in the first ten years the cause was obviously a major foreign debt crisis. What about the other 30 years? Since the end of the 1980s, the Latin American countries engaged in liberal or neoliberal reforms, one after the other, in consonance with the Washington Consensus, the name that liberal orthodoxy then received. The reforms were trade liberalization, financial liberalization, privatization not only of competitive but also of the monopolist sectors of the economy, generalized deregulation. Reforms that were supposed to make the countries return to fast growth were made, and failed to achieve the promised results: the region turned quasi-stagnant in the long-term. The liberal reformers have always a ready explanation for this: the reforms have not liberalized as much as it was necessary, but this kind of contrafactual reasoning is not falseable and, so, is not scientific but merely ideological.

In this paper we argue that the liberal orthodoxy (the sum of policies that neoclassical economists usually adopt and form a liberal policy regime) is incompatible with the growth of Latin America. Working from the perspective of the New-developmental Economics (a theoretical framework that is being developed since 2001), our hypothesis is that in the Latin American countries, the stage of their economic development and the fact that they are commodity exporters that suffer from the Dutch disease make economic liberalism unable to assure growth and catching up.[3] While, between 1930 and 1980, they adopted a developmental policy regime, neutralized the Dutch disease and were successful in industrializing and growing, in the 1980s they have fallen in the grips of a major financial crisis, which opened room to economic liberalism. Turned dominant from around 1990, the liberal policy regime condemned Latin America to quasi-stagnation.

We know that this is a bold hypothesis, but we believe that we have strong arguments in its favor. Before coming to them, however, we must make some simple assumptions. First, when the exchange rate tends to be overvalued for several years within a cycle which opens and closes with currency crises (something which is habitual in Latin America), it is determinant of investment. The explanation for this is simple. In their decisions to invest the companies take into consideration such exchange rate, realize that their investment project although technically competitive is economically non-competitive because the exchange rate is *disconnecting* the company from its demand, and don't invest or reduce their investment to the minimum.[4]

Second, we understand that heterodox policymakers as well as the orthodox policymakers behind either the developmental or the liberal policy regime, are reasonably competent economists. If they are liberal, they believe that the state should limit itself to guarantee property rights and contracts and keep the fiscal account balanced. If developmental they understand that the state should intervene moderately in the economy. Specifically, the developmental country should, first, keep the five macroeconomic prices right (a low interest rate, a competitive exchange rate that make viable the companies utilizing the best technology available, a wage rate that grows with productivity, and a low inflation rate, all assuring a satisfying profit rate that motivates companies to invest); second, it should keep balanced the fiscal account (except when countercyclical fiscal policy is required); third, it should keep balanced current-account – balanced if not showing a surplus when the country faces the Dutch disease; fourth, it should invest in the infrastructure; fifth, the developmental country should be engaged in temporary and strategic industrial policy to support capable companies to win the foreign competition.

Given these assumptions and what we understand by either liberal or developmental policy regimes, in the following section we will present the reasons why economic liberalism is unable to lead the Latin American countries to growth and catch up. We will discuss, first, how, under economic liberalism, Latin American countries interrupted their industrialization before it was consolidated; second, how they tried to grow with foreign indebtness policy, which is a self-defeating policy because appreciates the national currency; third, how they have used an exchange rate anchor to control inflation, which also causes appreciation; fourth, the neutralization of the Dutch disease; fifth, how central banks have tended to set an excessively

high level of the interest rate around which they manage their monetary policy; sixth, how they rejected capital controls, which are necessary to manage the exchange rate; seventh, how they were unable to practice a strategic industrial policy; eighth, how they besides discouraged private savings and investments by keeping the exchange rate most of the time, they rejected the importance of public savings and public investments; and nineth, liberal orthodoxy defended austerity and reject the countercyclical role of public spending.

First, non consolidated industrial development

All countries that formed their nation-state and industrialized, beginning with England in the second half of the eighteenth century did that in the framework of a developmental policy regime.[5] Nevertheless from the 1980s, in the framework of the Washington Consensus, the rich countries pressed the Latin American countries to change from a developmental to a liberal policy regime before they had arrived to a strong level of productive sophistication to resist to trade liberalization.

Classical Developmentalism emerged as a new discipline in the post-war period, when the Economic Commission for Latin America and the Caribbean - ECLAC prominent developmental economists, such as Prebisch and Furtado, to name a few, put forward a theoretical interpretation for the unequal development among the nations. Efforts to understand the economic development process of less developed countries led to the policy recommendation in favour of the industrialization of non-industrialized countries, aiming at improving their economies' participation in trade flows. Industrialization policy would follow a developmental strategy known as import substitution. In Latin America, this strategy had been observed since the II World War until late 1970s, and this is the period of the highest growth rate in the continent.

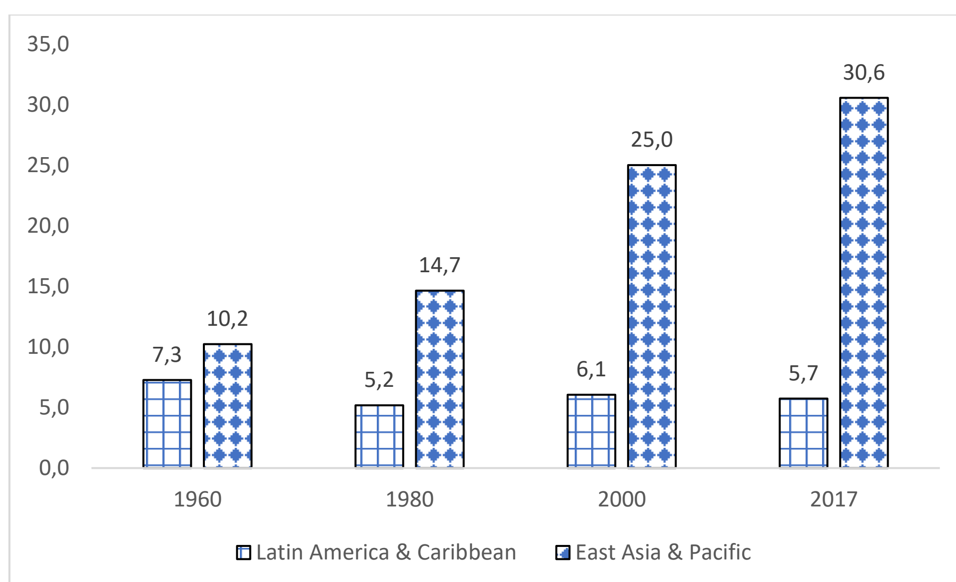
In practice, late industrialization gave periphery countries highly heterogeneous and less diversified productive structures, in contrast to the more homogeneous and highly diversified structure of the central economies. Their productive structure would be characterized as 'immature' and to attain a maturity phase, as conceived by Kaldor (1966), industrialization should be completed. Kaldor suggests four development phases in the industrialization process,[6] and argues, in the wake of the Keynesian tradition, that the maturing of an "immature" economy is based on the growth of aggregate demand. From this perspective, the capital accumulation generated by the industrialization process is the key variable of economic development, since it speeds up technological change to the benefit of the entire economy — as reflected in lower unit costs and higher-quality export products, enabling domestic producers to compete on foreign markets. Yet, this learning and industrial sophistication process requires time. The United States, for instance, realized its industrial revolution in the second part of the nineteenth century and only opened its economy in 1939. The Latin American countries, which were still industrializing in the 1980s, opened it around 1990, under the pressure of the new liberal truth that came to be called neoliberalism.

Despite all difficulties, the industrialization strategy based on import substitution and state intervention in Latin America was successful, but after the external debt crisis of the 1980s, pressured by the Washington Consensus, it was abandoned. and the process of overcoming it

spanned roughly the whole decade. The severity of the liquidity crisis that hit the highly indebted Latin American economies, following the sharp increase in the international interest rates and the default of the Mexican economy in 1981, left them with little room for manoeuver, and the liberal "reorientation to the market" phase started.[7] The way out of the long economic recession that followed the debt crisis (known as the 'lost decade') is associated with the economic opening implying trade and capital liberalization, privatization, and financial deregulation. The management of monetary and fiscal policies, on their turn, became chiefly subordinated to the views of the international financial markets. This subordination implied narrowing policy space for implementing developmental policies aiming at completing the industrialization process. In a word, the process of trade and financial integration of the Latin American economies from the 1980s onwards caught these economies in the process of catching up and implied the loss of autonomy for economic authorities to implement 'effective countercyclical macroeconomic policies consistent with longer-term development objectives and developmental policies'(Ocampo and Vos, 2008: 29). The management of countercyclical fiscal policy, a low and stable long-term inflation rate, low real interest rates, and a competitive real exchange rate proved to be difficult targets to be accomplished for most of the Latin American economies.

Figure 2 compares the share of the exports in the trade flow of both Latin America and Caribbean and East Asian and Pacific economies to illustrate the point the difference in the evolution of the productive structures of both regions. While in 1980 the share of exports of goods and services of the Latin America and Caribbean in world exports was 5.2%, in the East Asian and Pacific it was already 14.7%. After that, the share of East Asia and Pacif continued to grow accelerately while the Latin American stagnated.[8]

Figure 2: Share of exports of goods and services (current US$) of Latin America and Caribbean and East Asia and Pacific regions in world exports: selected years (%)



Source: World Development Indicators.

Second, growth with foreign savings

In the 1950s was already clear to the Latin American developmental economists that they face a foreign or balance of payment constraint – when the rate of growth in the Latin American countries increased, the current account deficit tended to appear and increase more. The two "perverse income elasticities" explain this structural problem: the income elasticity of the imports of manufactured goods is bigger than one, whereas the income-elasticities of imports of primary goods by the industrialized countries is below one. Thus, the current account deficit is endogenous in a region that remains exporter of commodities – deficits that bring along two evils: long-term overvaluation of the exchange rate and balance of payments crises. And a main problem for the Latin American policymakers was how to overcome this constraint or restrain the current account deficits. Classical developmentalists didn't know that besides causing balance of payments crises, current account deficits appreciated the national currency and harmed growth. But they knew they must limit the deficits and the means they found for that was to impose tariffs on the imports of manufactured goods, thus adopting the import substitution industrialization model, which had a double advantage: it limited the demand for dollars and encouraged industrialization which, eventually, was the only definitive solution for the problem.

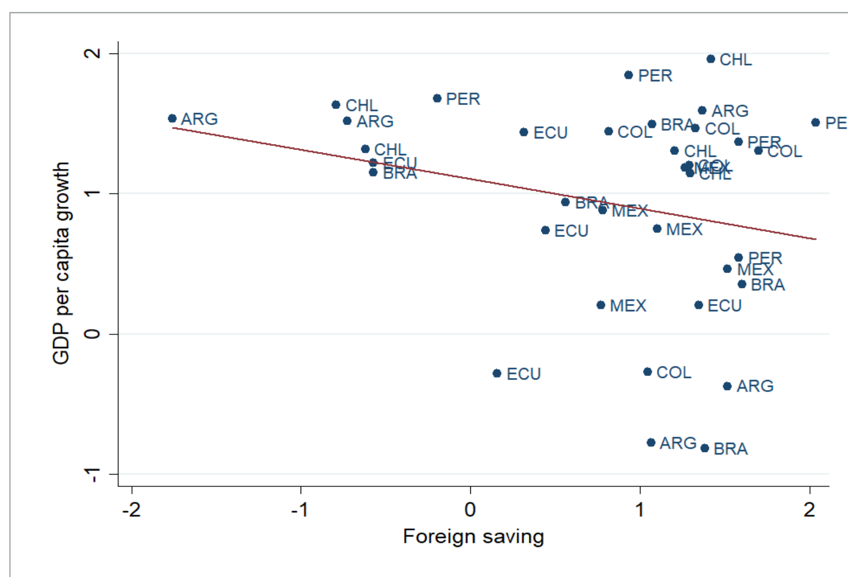
Liberal economists actively opposed such policy, which they called "protectionist" since the 1960s;[9] in the 1980s they were successful, and the desired trade liberalization has turned reality. In Brazil, for instance, the import tariffs and the export subsidies on manufactured goods averaged 45%. The tariffs were reduced to 12% and the subsidies, zeroed. The opening of the economy didn't solve the foreign constraint, but it was not viewed as a problem by the liberal orthodoxy. For them it is enough that the current account deficits do not make the foreign debt to increase faster rate than GDP. Once this condition is satisfied, the current-account deficits mean that the country is "growing with foreign savings", i.e., with foreign indebtedness. According to this thesis, the absorption of foreign savings complements domestic ones, increasing the economy's total savings.

Actually, following new-developmental economics, this view is an expression of exchange rate populism. Foreign savings rather replace than add domestic savings, because the capital inflows required to finance the defict appreciate the national currency and make the local companies not competitive, thus discouraging investment, while stimulating consumption by increasing artificially the acquisitive power of salaried people and rentiers. The assumption here is that rate of substitution of foreign for domestic savings is usually high in developing countries. In consequence, under normal circumstances, the rate of substitution of foreign for domestic savings tends to be high, and this is what has been happening in Latin America since the 1990s.[10] According to ECLAC, based on the consolidation of national accounts figures, from 1990 until 2018, the correlation between domestic and external savings is negative (-0.6). During this period, the share of domestic saving as a percentage of GDP was 19.7%, with little oscillation, and the average share of external savings was 1.9%.

Figure 3 illustrates how the strategy of growing with foreign savings in Latin America has implied less economic growth, with the trend line that when the economies show positive foreign saving, their GDP per capita growth rate is lower than when the opposite is observed.

Therefore, the Figure shows that the GDP per capita growth has been negatively correlated with foreign savings in the Latin American economies since the 1990s.

Figure 3: Latin America: Foreign savings and GDP per capita growth: 1990-2018



Source: IMF database.

Summing up, according to new-developmental economics, liberal orthodoxy's belief that the growth with current account deficits policy, besides leading countries to a balance-of-payment crisis, is associated with the long-term appreciation of the domestic currency and the discouragement of investment. These deficits correspond to a long-term appreciated exchange rate because countries engaged require *additional* foreign capital inflows to finance them, which appreciates the country's currency. Historical evidence of the dynamic Asian countries shows current account surpluses, a correspondingly competitive exchange rate, and high rates of investment and domestic savings. Therefore, their growth strategy is based on "foreign dissavings", despite the common wisdom saying that capital-poor countries should receive savings from capital-rich ones. Instead, Latin American countries have shown systematically current account deficits, low investment and savings rates, and low growth rates.

Third, anchor to control inflation

The use of the exchange rate as an anchor against inflation was another habitual policy that increased current account deficits, appreciated the national currency, aggravated the foreign constraint, and counted with the support of liberal orthodoxy. Liberal economists view as legitimate to control inflation through the use of an exchange rate anchor; they are comfortable in using "the price of the country" (the exchange rate) to control inflation, while they are critical of the populist politicians who use the prices of the state-owned enterprises. It is true that the majority of Latin American economies experienced high inflation and monetary instability during the 1980s and 1990s, as Table 1 shows, but the cost of stabilization was high. Although inflation came down quickly in countries that adopted exchange rate-based stabilisation, it led

to imbalances over the longer-term that increased the countries' vulnerability to financial crises. The appreciation of the exchange rate proved harmful to the manufacturing sector, and it discouraged exports of manufacturing goods and generated deficits in the trade balance and the current account balances. The result was an increase in the fragility of the Latin American economies which left the countries susceptibles to exchange rate crises.

Table 1 – Latin America and selected countries: inflation rate (consumer prices)

Period	LA and Caribbean	Argentina	Brazil	Chile	Colombia	Ecuador	Mexico	Peru
1980-89	170.7		328.1	21.4	23.4	34.0	69.0	481.3
1990-99	130.2		843.2	11.8	22.1	39.0	20.4	807.9
2000-09	6.0	8.6	6.9	3.5	6.3	17.8	5.2	2.6
2010-18	5.3	11.2	6.1	3.0	3.8	2.8	4.0	2.9

Source: IMF - World Economic Outlook Database, October 2019

Unlike Latin America where there was a recurring trend of currency overvaluation cycles in the 1980s and 1990s, the Asian countries concentrated on their export-led growth strategy with permanent stimulus to the export sector, avoiding exchange rate appreciation. While the former used the exchange rate as a stabilization tool, the latter used the exchange rate as a stimulus to the export sector.

Fourth, neutralization of the Dutch disease

The Dutch disease is a market failure that characterizes countries exporting mainly commodities where there is "the chronic overvaluation of the exchange rate caused by the abundance of cheap natural and human resources whose exports are compatible with an exchange rate lower than the one that would pave the way for the non-commodity tradables industries. Thus, in an economy with the disease two equilibriums must be considered – the current equilibrium which is defined by the commodities and balances the country's current account, and the industrial that makes competitive the manufacturing companies using the best technology available in the world in the respective industry. The Dutch disease is the difference between the two equilibriums, its severity, the relation between it and the current equilibrium.

We saw in the last section that the substitution of foreign for domestic savings that characterizes the habitual policy in Latin America of growth with foreign indebtedness made more important to neutralize the balance of payment constraint than it was for classical-developmental economics. An additional problem also brought by new-developmental economics (that the countries that successfully neutralized the Dutch disease would usually present a current account surplus) made the management and eventual overcoming of the fiscal constraint still more important. But in this case, the theory brought with it the solution: the specific way of neutralizing the disease.

The ideal way of neutralizing the Dutch disease is the imposition of a variable export tax on the commodities. Before the 1980s, the policymakers in Latin America didn't know the Dutch disease but knew that growth meant industrialization. Thus, intuitivelly they adopted high import tariffs that neutralized it on the domestic market, which is not the best way but it is politically more feasible, particulary when the exported commodity is agricultural and involves a large number of producers who will not accept such export tax easily.

While the import tariffs on manufactured goods aimed objectively to neutralize the foreign constraint, liberal economists call them protectionist. Actually, they are a second reason (the first was the classical infant industry argument) to legitimate import tariffs, not protectionist, just creating equal conditions of competition for the local companies. The difference is that in the case of the infant industry, the tariffs are necessarily temporary, while in the case of the Dutch disease, they will be required while the country export commodities that benefit from Ricardian rents or of price booms.

The Latin America and Caribbean region is traditionally exporter of commodities, and in 1990, according to ECLAC database, 66.8% of the total exports of goods from the region were of primary goods. The trade liberalization adopted by the Latin American countries in the framework of the Washington Consensus and liberal orthodoxy involved the abandonment of the mechanism that neutralized the Dutch disease on the domestic market (the import tariffs, which all countries adopted) and, in Brazil, the abandonment of the export subsidies on manufactured goods.[11] The consequence is well-known: deindustrialization, low growth and falling behind. Although this share is being reduced, reaching 48.2% in 2018, the deindustrialization process has been advancing in the continent: the manufacturing sector share in total value added decreased from 20.3% in 1990 to 14.3% in 2018.

Fifth, high level interest rate and exchange rate cycles

The use of an exchange rate anchor to control inflation and the growth with foreign savings policy are made operational by increasing the level of the interest rate around which the central bank conducts its monetary policy. Monetary authorities search legitimizing such high interest rates with the need to cool off aggregate demand, ignoring or not realizing that such usually interest rate level is not really required to control inflation but to attract foreign capitals which cause exchange rate appreciation. Indeed, to increase the interest rate is an obvious and legitimate policy to keep the prices right; but why move the interest rate down from, for instance, 7% percent level, instead of 3% level - a legitimate level considering, for instance, a 1% international interest rate and a 2% country risk?

During the 1980s and early 1990s, liberal policymakers adopted high real interest rates in Latin America which were a main cause for the overvalued exchange rate in the long term. A direct impact of exchange rate appreciation is on the price of tradable goods, discouraging exports and investments. An indirect effect is on the domestic prices through the relative decrease in the prices of imported goods, mainly raw materials and inputs, and, if the appreciation persists, in the substitution of imported products for local production.

In the Latin American countries the tendency to the overvaluation usually persists. It is built over a succession of exchange rate cycles of appreciation and depreciation. The cycle starts with an exchange rate crisis that leads to sharp depreciation. But after the crisis the exchange rate appreciates again, and it stabilizes for some years in an overvalued bottom level, corresponding to a current account deficit and increasing foreign debt. Only a financial bubble explains why the creditors take time to react, but they eventually lose confidence, suspend the roll-over of the debt, and another currency crisis closes the cycle.

For the new-developmental economics, following the Keynesian tradition, interest rates, around which the central banks make their monetary policies, should be kept at a low level, below the rate of growth of the economy, while the exchange rate should be competitive. If this virtuous combination between the interest rate and the exchange rate is achieved and sustained, then it is expected that the competent non-commodity producers should be made competitive using the best technology available in the world. On its turn, the wage rate should grow with productivity, not more than that, so that the profit rate would be satisfactory for competitive enterprises, especially those in the manufacturing sector.

Sixth, capital controls

The liberal orthodoxy rejects the capital controls which are often strongly required, not so much to avoid capital flight, which will not happen if a competent developmental policy rejects current account deficits, but to limit the capital inflows that unduly appreciate the national currency when the domestic markets are growing and attract the investments of multinational corporations.

Rey (2015: 1), in an influential paper based on empirical evidence, concluded that developing economies, financially integrated and without currency convertibility, are more sensitive to the global cycle, because “whenever capital is freely mobile, the global financial cycle constrains national monetary policies regardless of the exchange rate regime”.[12] This is because capital flows tend to have a pro-cyclical nature. In practical terms, in the absence of capital controls, when international liquidity is plentiful, excessive international flows tend to appreciate the currencies of these economies. Otherwise, when the international cycle is reversed, the currencies of these economies tend to suffer sharp depreciation.

Free capital movement has at least two consequences for developing economies that are indebted in foreign money. A first negative externality is to exacerbate exchange rate volatility. Several consequences follow from this. Given the importance of the exchange rate as a signal to the general operating conditions of the economy, its volatility induces a significant deterioration in public expectations, that is to say, the variation in the exchange rate may create adverse expectations among residents and nonresidents about the soundness of the economy. Moreover, as observed by Carvalho and Sicsú (op. cit: 178), even minor fluctuations in the exchange rate reduce the predictability of firms' financial operating costs, increasing uncertainty and lowering investment incentives. As a result, the cost of capital in these economies tends to rise with increased volatility. Also, the imbalances created by the free movement of capital are not transitory, because the pricing system is not flexible enough to adjust the productive structure, once relative prices change due to exchange rate fluctuation.

To increase policy autonomy and to reduce exchange rate volatility, most developing countries, including Latin America, after the currency crises that occurred in the second half of the 1990s have adopted a strategy of accumulating international reserves for precautionary purposes. Carvalho (2009) shows that the accumulation of reserves works as a 'liquidity cushion' to protect economies against adverse short-term changes in the balance of payments and allows for the accommodation of sudden demands for foreign currency. According to the author, the accumulated reserves can give some 'breath' for economic authorities to try to avoid the worst consequences of a sudden stop. However, regardless the strategic importance of the accumulation of large volumes of foreign reserves for developing economies, in most cases, the accumulation of reserves is not a choice, but a consequence of the capital inflows that are beyond the control of the economic authorities. In some other cases, reserve growth may be the result of the expansion of net exports, resulted from a boom in commodities.[13] In short, the accumulation of high levels of reserves in a volatile environment of capital flows is an important instrument, though far from a sufficient one, to counterbalance the uncertainty surrounding the behaviour of the capital account in developing economies financially integrated.

Capital controls are under the attack of liberal orthodoxy since Keynes published the *General Theory* in 1936. Today, it reflects the contemporaneous debate on the efficiency of markets as opposed to governmental regulation to better coordinate the functioning of modern economies (Carvalho and Sicsú, 2004).[14] Yet, since 2008, the liberal orthodoxy had no alternative but to accept the strategic role that capital controls often have. New developmentalism defends strongly capital controls because it defends that the essential macroeconomic policy is to keep the five macroeconomic policy right – the interest rate, the wage rate, the inflation rate, the profit rate, and, specially, the exchange rate – adopting for that whatever policies are required. Free capital movement in developing economies contribute to the cyclical overvaluation of the exchange rate – a damaging externality not so much because the increased volatility of the exchange rate turns long-term decisions more uncertain, but because when the exchange rate is overvalued in the long-term, decisions will be indefinitely postponed as the exchange rate disconnects the capable companies from their market. As put in Bresser-Pereira (2018: 2): "The exchange rate acts as a *switch* that grants or withholds *access* to existing demand, be it international or domestic." (italics in the original).

Given this perspective, capital controls,[15] together with the accumulation of reserves, are essential instruments to widening policy space, and increase potential of developing economies growth. [16] Carvalho (2009) registers three groups of measures of capital controls. The first group should apply to inflows by non-residents. This would inhibit the inflow of short-term financial capital, searching for interest rate arbitrage opportunities. A second group of capital account regulations should control outflows by residents. As noticed by Carvalho, based on the empirical observation of the balance of payment crisis in the late 1990s, residents are the first group of investors to promote capital flight. A last group of regulations should limit the possibility of domestic firms that sell to local markets to issue liabilities in foreign currencies. This would avoid the problem of exchange rate mismatches between assets and liabilities.

Seventh, industrial policy

The liberal orthodoxy rejects industrial policy which became a central policy for a second generation of classical-developmental economists that emerged in the late 1980s.[17] New-developmental economics supports industrial policy, but understand that, first, the country must get its five macroeconomic prices right and its current account, balanced. Industrial policy is not a substitute for the right macroeconomic prices. New Developmentalism's microeconomics involves a clear distinction between the competitive and the non-competitive sectors of the economy. In the non-competitive sector, which includes infrastructure and basic inputs companies and the large commercial banks "to big to fail", there is no market and the state is supposed to coordinate it with the use of planning and strong regulation. In the competitive sector, the coordination by market is much superior to the one by state, but a strategic industrial policy, temporary and dependent of results, is necessary. Industrial policy should focus on all activities that produce dynamic effects on the economy as a whole, well-coordinated with macroeconomic policies. In this sense, industrial policy should be seen as an essential complement to the macroeconomic policy regime, which should aim at keeping the five main macroeconomic prices 'right.' Following these orientations, the economy should be able to induce capital accumulation and simultaneously allow policy space for the implementation of appropriate industrial and technological policies to accelerate the catching-up process.

The advancement of the deindustrialization process in Latin America since the 1990s strongly suggests that industrial policies are relevant to restore a higher growth trajectory. According to Nassif et al (2018), in the structuralist and new developmentalism approach, industrial policy is defined as the combination of governmental incentives at the sectoral level, with horizontal policies.[18] In the first case, it is included tariff protection on imports, subsidies within limits imposed by the World Trade Organization - WTO, and, most important, long-term public credit for investment projects and innovation. In the second case, horizontal industrial policies should target investment in infrastructure and research and development - R&D.

Among all instruments of industrial policy, tariffs are historically the most important, even in today rich countries or middle-income countries because they have been used to neutralize the Dutch disease. The exception is East Asia, in which, not having commodities to export, after a very short import substitution industrialization, became a exporter of manufactured goods. Thus, it is not only the infant industry argument, but also the neutralization of the Dutch disease argument that legitimize industrial policies based on tariffs on the imports of manufactured goods.

Eighth, public savings and public investments

Liberal orthodoxy disregards the importance of public investment. It believes legitimate to transfer to the private sector the monopolist infrastructure public services, using the argument that "private are more efficient than public companies". This is false. To privatize the infrastructure is to lose control of the investments required for growth. The investor in the privatized monopolies are not really business entrepreneurs. When they get hold of a company,

they are usually responsible for making investment. They do the minimum possible, they delay the investments, and they increase the prices in the first opportunity while the quality of the services deteriorate.

There are two main approaches in the economic literature that address the role of fiscal policy and analyse its impact on the determination of private investment: the neoclassical approach and the Keynesian approach. The first is opposed to activist fiscal policy, assuming that there is a crowding-out effect between public and private investment. It also stresses the inflationary consequences of fiscal expansion and the problems related to the expansion of public debt. The second approach, based on the principle of effective demand of John Maynard Keynes (1936) and Michal Kalecki (1954), is in favour of contra-cyclical fiscal policy, and control on public debt.

Concerning the crowding-out effect, the idea is that a rise in investment by the public sector can inhibit private investment, assuming that the use of physical inputs and financial savings by the public sector will limit the availability of these resources to the private sector. Also, public investment would pressure up the price of inputs and, above all, interest rates. Interest rates should rise because it is assumed that public expending is to be financed through increased compensation for public bonds. If so, credit would be reduced to the private sector that would then reduce investments. This is how the crowding-out effect would work. Besides, expansionary fiscal policies will bring up inflationary risks, as well exposed in the neoclassical synthesis model set up by Hicks (1937), as well as in the monetarists and new-classical models.

Differently, public spending increases the level of activity, what leads to higher aggregate savings – instead of reducing the loanable funds available to private agents (Camara Neto; Vernengo, 2004–5). According to Keynes's investment theory, the private decision to invest in capital goods depends on long-term expectations of profits which are driven by the 'animal spirits'. Short-term interest rates or cost-of-capital variables play no role on decisions that involve the 'animal spirits'. On this, Fazzari (1994/1995: 232) based on a detailed examination of the behaviour of US individual firms on investment, concludes: "…. there is little if any loss to investment from possible deficit induced increases in interest rates, while there may be substantial gains for investment caused by the economic stimulus resulting from deficit."

Gavin and Perotti (1997) analysed the fiscal policy in Latin American countries from 1970-95 and found that it had been procyclical, and particularly in periods of low growth. Alberola et al. (2016) investigated the relationship between fiscal policy and the cycle in Latin America and also concluded that fiscal policy is procyclical. According to the authors, the main explanation for that is financing conditions "Worsening financing conditions, which tend to coincide with difficult economic times, constrain fiscal policy. Favourable financing conditions, more prominent in good times, favour fiscal profligacy" (Alberola op. cit: 24)

Table 2 shows for selected regions and years that public investment-to-GDP ratios have remained relatively stable. Latin America and the Caribbean is the region with the second-lowest public investment-to-GDP ratio. Also, the share of private investment-to-GDP increased throughout the period, from 10% in 1990 to 15% by 2015, confirming that private investment drove the increase in total investment in the region, while public investment remained stable.

Table 2 – Public and private Investment-to-GDP ratio(%), selected regions 1990 - 2015

Public Investment				
Region	1990	2000	2010	2015
East Asia & Pacific	9	14	14	11
Eastern Europe & Central Africa	3	2	3	3
Latin America & Caribean	4	3	4	4
Middle-East & North Africa	5	4	8	7
South Asia	6	5	6	4
Sub-Saharan Africa	4	4	5	5
Private Investment				
Region	1990	2000	2010	2015
Eaest Asia & Pacific	13	12	22	26
Eastern Europe & Central Africa	19	10	11	12
Latin America & Caribean	10	14	15	15
Middle-East & North Africa	8	9	11	11
South Asia	10	12	18	18
Sub-Saharan Africa	9	9	12	13

Source: Castellani et al. (2019).Note: East Asia and Pacific (EAP), Middle East and North Africa (MNA), Eastern Europe and Central Asia (ECA), Latin America and Caribbean (LAC), South Asia (SAS) and sub-Saharan Africa (SSA).

Nineth, austerity

We left to end the more often critique of liberal orthodoxy: that whenever there is some signal of macroeconomic disadjustment, it proposes to cut public expenditures while it refuses to adopt countercyclical fiscal policy when demand is feeble, insufficient to make companies to invest. This is "austerity", that post-Keynesian economists duly criticize. It is the opposite to vulgar heterodoxy, which has also its solution for all problems: to expand public expending. Liberal orthodoxy criticizes this stand, which it views as ecnomic populism – the state spending more than it gets irresponsibly. But liberal orthodoxy also gets often involved in populism, not fiscal but exchange rate populism. When the external accounts show disadjustment accompanied by the increase of inflation, the standard policy response is to cut public expending, increase the interest rate, and depreciate the national currency, but liberal austerity means to exclude depreciation from the adjustment program, while raising more the interest rate and proceeding a higher fiscal contraction. Such austerity is a middle-class exchange rate populism, because while the internal adjustment only hits the poor and the lower middle-class by producing recesson and unemployment, depreciation hits also the rentier middle-class and the rich. It is not difficult to conclude from this analysis that the general outcome of liberal austerity is lower growth if not stagnation.

Conclusion

In this paper we offered nine arguments why liberal policy regimes, which became dominant in Latin America from the 1990s, are incapable of making the region to grow and catch up. On the contrary, what we are seeing is quasi-stagnation. We showed that the Latin American economists, beginning with Raúl Prebisch, understanding that countries should industrialize to grow, already in the 1950s realized that the balance of payment constraint led countries to chronic shortage of dollars and was a major obstacle to growth. Their response was to adopt import tariffs on manufactured goods which lead to a successful import substitution industrialization. Yet, from the 1980s, with neoliberalism and neoclassical economics becoming dominant in the North, Latin American countries, debilitated by a major foreign debt crisis, abandoned such policies, adopt the neoliberal reforms, and since then experience quasi-stagnation. More recently, new developmental economists have also responded to the balance of payment constraint with the critique of the growth with foreign indebtedness and the use of exchange rate as an anchor to control inflation because both policies have appreciated the national currencies and caused deindustrialization. They showed as well that the Dutch disease also involves a non-competitive exchange rate that precludes industrialization or, when the country is already industrialized, causes deindustrialization. And argued that to neutralized it, they adopted import tariffs, thus adding a second condition that makes import tariffs non-protectionist (the first is the infant industry argument). In this way, while the liberal orthodoxy ignores the foreign constraint, and post-Keynesian as well as classical-developmental economists focused in this proglem, new-developmental economists gave an additional emphasis to the problem by its critique of the current account deficits and its analysis of the Dutch disease which, when neutralized, tends to produce current account surplus. Following from that the policy conclusion that the foreign constraint requires whatever policy is necessary to overcome or contour in the short-term the constraint and solving it in the long-term by turning the country industrialized. Liberal orthodoxy, instead, ignores the Dutch disease and views current account deficits as a good thing because they involve "foreign savings", not considering that the required capital inflows appreciate the national currency and encourages consumption, while discouraging investment.

We didn't include in our discussion the political economy involved, except when we referred to exchange rate populism. In contemporary capitalism, the orthodox policymakers represent mainly the interest of rentier capitalists (who live out of interests, dividends and real estate) and financiers, who manage the wealth of rentiers and act as their organic intellectuals. The policies defended by liberal policymakers reflect such class commitments that cause major distortions in the policymaking process. Liberal orthodoxy is right in defending fiscal discipline, which is a condition for long-term growth as it required for the state achieving public savings to finance public investments which, combined with private investment, are the main variable determining growth. But fiscal discipline is not fiscal austerity. When a developing country faces excess demand, currency crisis and inflation, the effective policy is a combination of fiscal adjustment with currency depreciation; when it faces unemployment, the effective policy is fiscal expansion and monetary finance by the central bank. The liberal orthodoxy defends fiscal adjustment in any circumstance which hits more the poor than the rich and rejects depreciation that hits more the rich than the poor. Austerity is a way of doing

excess fiscal adjustment and no currency depreciation; it is to recover the competitiveness of the country by reducing just the wages of workers instead of also the profit and wealth of the rentier capitalists by depreciating the currency.

Differently from fiscal populism, exchange rate populism is not a problem of choice, but a question of destiny for liberal orthodoxy. Since the liberal economist believes that the market coordinates well the exchange rate, he rejects exchange rate policy. Besides, he believes that to try to grow with foreign indebtedness is the right thing to do. Thus, when the current account deficits show up, he sees them as natural. It is not. Current account deficits are the main cause of loss of economic competitiveness and of cyclical financial crises. Together with high interest rates, they are in the core of the financialization process.

Summing up, a liberal policy regime is incompatible with growth in the Latin American countries. Economic liberalism is bad also for rich countries and for countries that don't suffer from the Dutch disease. Policy regimes are either liberal or developmental. A Keynesian policy regime is a developmental regime to the extent that it defends a moderate state intervention. The fact that the regime is developmental does not mean that it will work well. It depends on the capability of the policymakers. This, however, is not the case of the liberal policy regimes. They count too much with the coordinative capability of markets, ignoring that they are unable to coordinate the non-competitive sectors of the economy and to keep right the five macroeconomic prices. In consequence, they adopt the policies that we discussed in this paper, which are inimical of growth and catching up.

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[1] Bresser-Pereira, Araújo and Peres (2020).

[2] Note that we are using the word "liberal" in its original or academic meaning, not in the American or colloquial meaning.

[3] For a summary of new-developmental economics and its political economy see Bresser-Pereira (2010; 2020). For a systematic presentation of its development macroeconomics, see Bresser-Pereira, Oreiro and Marconi (2014).

[4] Bresser-Pereira (2014).

[5] The Industrial Revolution happened in the context of Mercantilism, the first historical developmentalism.

[6] See Feijó and Lamônica (2012).

[7] In the words of Bresser-Pereira (2002: 6):"After 1982, when the debt crisis broke, macroeconomic instability emerged as the central economic problem. Latin American countries had no alternative but to adjust and reform."

[8] According to UNIDO (https://stat.unido.org/database/MVA%202019,%20Manufacturing;jsessionid=D1874726E6DDCE4AAA6D159E27056F2C), in 1990 the share of manufacturing value added in total GDP in Asia was 18.1% and 16.5% in Latin America. In 2018 these shares were 22.5% and 12.8%, respectively, which illustrates how deep deindustrialization has advanced in Latin America since the 1990s. For a discussion on Latin America deindustrialization, see, among others, Palma (2005).

[9] See Ian Little (1982) for an engaged and bright survey of the liberal thinking on that issue.

[10] Bresser-Pereira and Nakano (2003), Bresser-Pereira and Gala (2008), and for an empirical study on Brazil see Bresser-Pereira et al (2014).

[11] Brazil subsidized the exports of manufactured successfully between 1967 and 1990. In 1965, exports of manufactured goods represented 6 per cent of all goods exported; in 1990, 62 percent! Presently, represents 30 percent.

[12] On this, Carvalho (2008: 273) states: "It is consensual among economists that opening the capital account of the balance of payments reduces the domestic autonomy in the choice of goals and instruments for monetary policy. In fact, it is practically a tautology, since opening the capital account increases international financial integration and this means precisely that the national economy becomes part of some bigger economic unit".

[13] Besides, the management of foreign reserves as a policy instrument imposes restrictions on domestic policies, since the impact of capital flows should be sterilised. If economies work with relatively high rates of interest, consequently the cost of sterilisation will be higher, and this cost is reflected in an increase in the burden of public debt.

[14] See, also, Kregel (2008); Ocampo and Stiglitz (2008) and Arestis (2016).

[15] Chile is a well succeded example of capital controls established in the late 1980s.

[16] It should be added that new developmentalism also proposes the creation of a sovereign fund (following the Norway example) to be built with the revenue of an export tax imposed on export of commodities. The creation of this fund would prevent capital inflow and therefore contribute to fighting the appreciation trend of the exchange rate. On the other hand, the tax on export of commodities would be the instrument to neutralise the Dutch disease. This tax would increase the cost of production of commodities and, in this sense, it would make the current equilibrium exchange rate to converge to the industrial equilibrium.

[17] See Bresser-Pereira (2020) for an explanation for the 'right' levels of the macroeconomic prices.

[18] Ocampo (2005) also advocates in favour of horizontal and sectorial industrial policies, as the dynamic of productive structures results from the interaction between activities, firms, **sectors** and institutions.