Challenge

ISSN: 0577-5132 (Print) 1558-1489 (Online) Journal homepage: https://www.tandfonline.com/loi/mcha20

A New Theoretical Framework: New Developmentalism

Luiz Carlos Bresser-Pereira

CHALLENGE
2020, VOL. 63, NO. 3, 114–132
https://doi.org/10.1080/05775132.2019.1705006

A New Theoretical Framework: New Developmentalism

Luiz Carlos Bresser-Pereira

ABSTRACT
New Developmentalism is a theoretical framework being defined since the early 2000s searching to understand why most middle-income countries are falling behind the East Asian ones. It is a political economy and a development macroeconomics that originates from development economics and Post-Keynesian Macroeconomics. It argues that fast growth and catching up have been associated to developmentalism, not to economic liberalism. It defines the developmental state as the one that not only is engaged in industrial policy but also manages actively the five macroeconomic prices–mainly the interest and the exchange rate to keep competitive economically the companies that are technically efficient. New developmentalism is critical of fiscal indiscipline, while defends countercyclical fiscal policy, and is strongly critical of current account, arguing that growth is made at home. It has a new model of the Dutch disease from which is possible to deduce the means to neutralize it and achieve economic competitiveness.

The East Asian countries were the only countries that in the twentieth century successfully caught up and became developed countries. The remarkable books of Chalmers Johnson (1982) on Japan, Alice Amsden (1989) on South Korea, and Robert Wade (1990) on Taiwan focused the industrial policies they adopted and appropriately defined them developmental states. These three books plus two historical books by Ha-Joon Chang (2002) and Erich Reinert (2007) gave a new impulse in Classical Developmentalism (or Development Economics)–the school of thought that was part of the mainstream between the 1940s and the 1970s, but together with the Keynesian school, came to crisis in the late 1970s when the neoliberal ideology turned dominant and Neoclassical Economics returned to the condition of mainstream. New Developmentalism, based on that two heterodox schools, is offering a new and encompassing theoretical framework, which, differently from Post-Keynesian Economics, is from the start an open and growth-oriented theory, and, from Classical Developmentalism, has a macroeconomics–more precisely a development

CONTACT Luiz Carlos Bresser-Pereira bresserpereira@gmail.com School of Economics, Getúlio Vargas Foundation, 132 São Paulo, Rua Araripina, São Paulo, SP 05603-030, Brazil.
Luiz Carlos Bresser-Pereira, born in 1934, is emeritus professor of Getúlio Vargas Foundation. He was finance minister (1987) and minister of federal administration (1995–1998) of Brazil. His is author of many academic papers and books, among which *Development and Crisis in Brazil* (Westview, 1984), *Democracy and Public Management Reform* (Oxford, 2004), *Globalization and Competition* (Cambridge, 2010), and *The Political Construction of Brazil* (Lynne Rienner, 2016). In the last 15 years, he has been developing a new theoretical framework, New Developmentalism, whose political economy argues that capitalism was born not liberal but developmental, while its macroeconomics focus on the determination of the exchange rate and on the current-account, which should present a surplus to avoid the national currency turns overvalued and discourage investment.

macroeconomics.[1] This framework was originally oriented to the study of middle-income countries, but may come to be relevant also to rich countries.

New Developmentalism argues that there are two alternative forms of economic organization of capitalism. One, which searches to exclude the state of the coordination of economic systems, is called economic liberalism. The other, that views the market as an extraordinary institution for the coordination of competitive systems but defends a moderate state intervention in coordinating the noncompetitive industries, the financial system, and the macroeconomic prices that the market is unable to keep right. This alternative form organization of capitalism, although dominant in the time of the industrial revolutions of all countries and in the postwar Golden Era of capitalism, lacks a name. New Developmentalism makes a semantic enlargement an proposes to call "developmentalism" this form of capitalism, thus adopting a broad concept of developmentalism. An alternative economic regime clearly distinguished from economic liberalism as well as Soviet style statism–two radical and inefficient forms or organizing capitalism.

While conventional economics adopts a primarily hypothetic-deductive method and achieves logical but poorly related to reality models, New Developmentalism, similarly to Post-Keynesian Economics, adopts a historical-deductive method which allows for more modest but realistic models. Its models do not derive primarily from axioms like the rational economic agent or the law of diminishing returns, but from the observation of the reality and the generalization of its regularities and tendencies. The new-developmental models check the economic experiences of liberal and developmental economic regimes–experiences that are usually more successful in developmental regimes as the great historical periods of growth (the industrial revolutions in England, France, the United States, Germany, Japan, Brazil and China, as well as the Keynesian postwar Golden Era) demonstrate. The New Developmentalism is a theoretical framework that emerged in the 2000s as a response to the crisis of Post-Keynesian Economics and development economics from the late 1970s and as an alternative to the dominant Neoclassical Economics and its liberal orthodoxy. It is a theoretical framework which starts from the assumption of an open and dynamic economy. It is critical of the hypothetic-deductive method used by conventional economics which an economics disconnected from the reality. It views markets as an extraordinary institution to coordinate competitive economic systems but does rejects the liberal vision of the economy in so far as views the state as an economic actor that, besides guaranteeing private property and contracts, is supposed to coordinate the noncompetitive industries and the five macroeconomic prices, which the market is unable to keep right. It rejects orthodox austerity but defends a responsible countercyclical fiscal and an exchange rate policy associated to a current account policy.

Classical developmentalism was born in the United Kingdom in the 1940s, in the transition from the League of Nations to the United Nations, under the name of "development economics". As this expression is too general, I prefer to call this school of thought Classical Developmentalism, from which Latin American structuralism was part. Between 1940 and 1980 Classical Developmentalism was the mainstream theory of economic development. It was adopted by the World Bank, had as purpose to understand the underdeveloped character of developing countries, and propose policies to achieve the catching up. The main contribution of Classical Developmentalism was the definition of economic development as "structural change" or industrialization. To legitimize industrialization and the intervention of the state in the economy, Raúl Prebisch (1949) proposed the deterioration of terms of trade hypothesis and the model of the balance of payments constraint, Rosenstein-Rodan (1943) and Albert Hirschman (1958), the positive externalities, Arthur Lewis (1954), the transference of labor to the manufacturing industry as a means to increase productivity.

The crisis of Classical Developmentalism began in the late 1960s with the new dominance of the Associated Dependency Theory–a Marxist critique of the possibility of industrial revolutions led by the national bourgeoisie in the developing countries. Although this theory is often understood as a defense of economic nationalism, in fact it was a critique of developmentalism and the defense of the association-subordination of Latin American countries to the US. As Bresser-Pereira (2011) argues, dependency theory' basic claim is that, in developing countries, the industrial bourgeoisie is dependent, not nationalist, thus a national-bourgeois revolution, as it had happened in rich countries, would be impossible. From this assumption derived two lines of thought: (a) Andre Gunder Frank 1966) and his "super-exploitation" version claimed that the solution would be a socialist revolution, while(b) Cardoso and Faletto (1969) and their "associated dependency" version concluded that the solution was the association with the multinational corporations, Both views represented a major blow in the Latin American economic nationalism and in the critique of imperialism. The crisis deepened around 1980, when, in the framework of the Neoliberal Turn, Neoclassical Economics became mainstream in the universities, rich countries abandoned their Keynesian or developmental policies, and the World Bank changed from a developmental agency to an instrument of the US to impose the neoliberal reforms, while the developmental policy regimes proved unable to face the 1980s' Foreign Debt Crisis.

From the late 1980s, the Latin American countries, under the influence of the new neoliberal hegemony, gave up developmentalism and adopted the neoliberal reforms. Growth, however, was not resumed. Instead what we saw was deindustrialization, reprimarization, low growth rates and financial instability, while the East Asian countries continued to grow fast and become rich. This framework (the failure of the developmentalism in the 1980s followed by the inability of liberal-orthodoxy in the 1990s to restore growth) motivated Bresser-Pereira and a growing group of economists in Brazil and Argentina to start designing New Developmentalism. In the early 2000s, neither Classical Developmentalism or liberal orthodoxy offered analytical instruments to understand the quasi-stagnation of the Latin American economies. The time for a new theoretical approach to economic development was ripe. New developmentalism received this name *not* because, after the failure of the 1990s neoliberal reforms, some countries searched to go back to developmental policies, like Brazil and Argentina, but *because* the new theory had as its main historical or empirical reference the success of the developmental states in East Asian.

In their books, Johnson (1982), Amsden (1989) and Wade (1990) attributed the catching up of respectively Japan, South Korea, and Taiwan to the adoption of successful industrial policies. They were right and represented a renovation of Classical Developmentalism. But their readers may not have paid due attention to the fact that in these countries an active macroeconomic policy, especially an exchange rate policy, kept the five macroeconomic prices right or very close to being right. New Developmentalism's novelty was to ascertain that the market is unable to keep the macroeconomic prices right and to argue that the state will be a developmental state if it able to conduct successfully macroeconomic policies that keep the interest rate relatively low, the exchange rate, competitive, and the current account balanced or showing a surplus.

Developmental or Liberal Capitalism

Per New Developmentalism there is not just one form of economic organization of capitalism, economic liberalism, but two, economic liberalism and developmentalism. Capitalism will assume this or that form depending on how the state performs its coordinative role. Capitalism is liberal when, in the economic sphere, the state limits itself to guaranteeing property rights and contracts and to properly managing its fiscal accounts; it is developmental whether the state moderately intervenes in the market through an active macroeconomic policy and a strategic industrial policy and adopts a reasonable economic nationalism in competing economically with other nation-states.

Nation-states–the specifically capitalist political-territorial society formed by a nation, a state, and a territory–are intrinsically devoted to economic development. In each nation-state that succeeds in industrializing, the nation organizes itself into a developmental class coalition, which faces the opposition of a liberal class coalition. The participants of developmental and liberal class coalitions varied in history; the first modern developmental class coalition was the mercantilist one associating the monarch, his patrimonial court, and the rising high merchants and financiers. In the industrialization phase of each country they have been essentially authoritarian; turned democratic in the second developmentalism–the Golden Era of Capitalism–in the post Second World War. Today, in middle-income countries, the industrial bourgeoisie, the urban industrial workers, part of the salaried middle class, and the public bureaucracy form typically the developmental class coalitions, while rentier capitalists, financiers, and the top executive of the great private corporations form the liberal class coalitions, dominant in the rich world since the 1980s. For that reason, present-day capitalism may be called rentier-financier capitalism.

New developmentalism sees economic liberalism at one extreme, statism in the other extreme of economic spectrum. It rejects statism, which is intrinsically inefficient. Statism, from which the Soviet Union was the best example, worked just in the beginning of industrialization; it proved unable to coordinate an economic system once it becomes large, complex, and depending on innovation. It also rejects economic liberalism, which, in normal conditions, considering reasonably administrations, tends to be less efficient than the developmental policy regimes. Developmentalism, not economic liberalism, was the default form of capitalism. Historically, capitalism was born developmental during mercantilism. The first industrial and capitalist revolutions, in England, France, and Belgium, have occurred at that time. Latecomers central countries, like Germany and the United States, engaged in their industrial revolutions, following the developmental, not the liberal form.

The liberal phase of capitalism began in England began in 1846, when it opened its economy, and ended with the stock market crash in 1929 and the Great Depression. It followed the second developmentalism, comprising the New Deal, the Bretton Woods Agreement, the Golden Years of Capitalism, and the formation of Social State. While in the first developmentalism the political regime was authoritarian. in the second it was democratic and devoted to the guarantee of social rights.

Outside the central countries, East Asian countries, India, Russia, the major Latin American countries, South Africa and Turkey have also made their industrial and capitalist revolutions, invariably adopting the developmental strategy. Most East Asian countries already turned rich, or, in the case of China, are striving in this direction, while the other middle-income countries have been growing slowly from 1980 and are just middle-income countries. Conventional economics proposed that these countries are facing a "middle-income trap", whose causes are not clear. New Developmentalism, instead, associates this *new* inability of middle-income countries to catch up to a historical new fact: the radical economic liberalism that central countries adopted from the 1980s and imposed "successfully" to peripheral ones. East Asian countries, Vietnam and India, which have a firmer idea of nation, are an exception: they were able to resist to neoliberalism (Bresser-Pereira 2019).

In working with the concept of class coalitions, New Developmentalism distinguishes business entrepreneurs from rentier capitalists, the former divided into entrepreneurs in the tradable non-commodity (or, to be short, manufacturing entrepreneurs), the tradable commodity, and the non-tradable sectors. While entrepreneurs invest and innovate, the rentiers live out of interests, real-estate rents, and dividends. Within the managerial social class, we must distinguish the top executives of the great corporations, the financiers and the public bureaucracy from the other managers and employees. The paradigmatic developmental class coalition associates industrialists with the public bureaucracy and the working class. It is in opposition to the liberal class coalition that dominated developing countries before their industrial revolution, formed by the commodity exporters, consumer goods importers, the traditional or high middle-class, and the foreign interests. After these countries industrialized, and once neoliberalism and financialization turned dominant, rentiers, financiers, the high middle-class and the foreign interests form the liberal class coalition. Given the new ideological hegemony of economic liberalism, and the ambiguous or contradictory character of the industrial elites in developing countries (sometimes developmental, sometimes liberal and dependent), turned increasingly difficulty to build developmental class coalitions in middle-income countries.

The Five Macroeconomic Prices

New Developmentalism's developmental macroeconomics starts from the definition of five macroeconomic prices (interest rate, exchange rate, profit rate, wage rate, and inflation rate) and two major macroeconomic accounts: the fiscal and the external or current account. New Developmentalism claims that markets are unable to keep right the five macroeconomic prices and the current account. The history of capitalism is the history of economic and financial crises that are the consequence of wrong macroeconomic prices, usually an excessively high interest rate, an overvalued exchange rate, and, in consequence, an unsatisfactory profit rate and an unbalanced current account. The central banks were created to keep right the interest rate and the inflation rate. This is not enough. Developing countries need dramatically institutions that allows governments to practice policies for each one of the five macroeconomic prices, particularly for the exchange rate.

Profit rate

The net expected profit rate for the manufacturing industry is often non-satisfying, i.e., the expected profit rate minus the cost of capital does not motivate companies to invest, because an overvalued exchange rate turns noncompetitive companies that use the best technology available in the world. is overvalued and makes them not competitive.

Interest rate

It is often above the difference that the country risk justifies. Economic populism (either fiscal, the state expends irresponsibly, or exchange rate populism, the country expending irresponsibly and incurring in current account deficits) are one of the causes for that; the others are the political power or rentiers and financiers, the two habitual policies which depend on a high interest rate to attract capital inflows.

Wage rate

While the Lewis' unlimited supply of labor holds, the wage rate in developing countries tends to increase less than the rate of increase of the labor productivity. Once, however, the country turns a middle-income country, wages will tend to increase with the increase of productivity.

Inflation rate

In the short-term, excess demand associated to fiscal populism or fiscal indiscipline is a cause that explains relatively small inflation. The acceleration of inflation is often due to the practice of using the nominal exchange rate and the prices of state-owned enterprises to control it; when, eventually, these prices are corrected, the inflation accelerates; if in this economy is formal or informally indexed, inflation will tend to turn inertial and will remain in its new higher level.

Exchange rate

It tends to be overvalued in the long-term. We have already explained why.

To make the five macroeconomic prices right is not sufficient that the country keeps balanced the fiscal account. It must also keep balanced its current account, reject two "habitual policies" (the growth with foreign indebtedness policy and the exchange rate anchor policy to control inflation), maintain the interest rate relatively low, and neutralize the Dutch disease.

Growth, the Exchange Rate and the Access to Demand

New developmentalism adopts a simple growth model where growth depends on investment and on technological progress, which is embodied in physical and in human capital. Using not the Harrod-Domar model, but simply the respective accounting identity, we have that growth depends on the rate of investment minus the growth of the population.

$$g = \alpha I/Y - n$$

In this identity, g is the per capita growth rate, α is the output-capital ratio or the productivity of capital, I/Y is the rate of investment, and n, the growth of the population. Considering the later, constant, we see that the higher the investment rate and the higher the productivity of capital are, the higher will be the growth rate. Investment, on its turn, depends on the expected profit rate, minus the interest rate or the cost of capital.

The economic role of the state in the process of capitalist development is to guarantee the six general conditions of capital accumulation. From them, four are on the supply side: (1) education and health care, (2) institutions which guarantee the well-functioning of the market, (3) investments in the infrastructure, and (4) finance to investment. Keynes added the fifth condition (5), the existence of demand. New Developmentalism adds the sixth one: (6) the *access* to demand, that the exchange rate guarantees or denies. While the Keynesian condition imposed itself due to the historical tendency to the insufficiency of demand, the new-developmental condition derives from another historical tendency: the fact that the exchange rate in developing countries is not just volatile but tends to be overvalued in a long-term cycle, between two financial crises.

Test-books in economic development don't have room for the exchange rate, which is viewed as a short-term monetary variable, while growth theory works in the long-term. Yet, from the start, in the early 2000s, New Developmentalism' main hypothesis was that the exchange rate is a strategic variable in the process of growth. While New Developmentalism gradually developed the theory to explain why, a growing number of empirical researches verified the positive relation between the exchange rate and growth.[2] The second and the fourth and fifth studies were associated to new-developmental research. New Developmentalism's explanation for the role of the exchange rate and the current account in the process of growth is simple. It assumes that there is in developing countries a tendency that the exchange rate is overvalued cyclically–that there is an exchange rate cycle, which ends with a financial crisis. Between the two crisis the exchange rate remains overvalued and the current account shows a deficit for several years. Thus, the foreign debt and the indebtedness of the companies and the households increase. But after some years the creditors lose confidence, and financial crisis characterized by a new and sharp devaluation puts an end in the cycle.

After a financial crisis defined by the sharp devaluation of the national currency, two variables make the exchange rate to appreciate again: a non-neutralized Dutch disease and a high interest rate, which is associated to two policies that policymakers in developing countries habitually adopt and New Developmentalism criticizes: the growth with foreign indebtedness policy and the use of an exchange rate anchor to control inflation.

Determination of the Exchange Rate

According to New Developmentalism, the exchange rate is not merely determined by the supply and demand of foreign currency, as is generally assumed by conventional economics. The value of the foreign currency, as well as the tendency to the cyclical and chronic overvaluation, determine the real exchange rate structurally. The exchange rate is the price of the foreign money that balances the country's current-account. In so far that the foreign money represents goods and services, it has a value, and its price revolves around it according to the demand and the supply. The value covers the cost but a reasonable profit on the production of the goods and services that the country exports. It varies according to the variation in the index of the unit labor cost of the country compared with the unit labor cost of its main competitors. When the comparative unit labor cost of a country increases, either because wages increased more or the productivity increased less than in its competitors, the value of the foreign money increases (or the value of the national money falls) and the national currency must depreciate to keep the current-account balanced. While value of manufactured goods changes substantially according to the variations of the country's unit labor cost, on the comparative variations of wages and productivity, the value of the commodities is relatively constant, but their prices vary strongly producing booms and busts–the exchange rate cycle–with certain regularity.

On what depends the supply and demand of foreign currency? On the imports and exports of the country and on the capital flows. The import and exports depend on the variation in the terms of trade, on the emergence of a new source of supply or demand, on the rate of growth, and on the income elasticities of imports and exports. As for capital flows, which have increased enormously with globalization, they depend on the difference between the interest rate in the country and in its main competitors. It is common the assertion that they are an autonomous cause of the exchange rate volatility and would make it fundamentally unpredictable because they would be primarily speculative.

The Exchange Rate Cycle

For the New Developmentalism, even though it acknowledges the existence of purely speculative flows of capital, they mostly follow the logic of the tendency to cyclical and chronic overvaluation of the exchange rate. As we can see in Figure 1(b), a previous exchange rate cycle ends when the country loses foreign credit, capital inflows stop, a financial crisis unleashes, and the national currency depreciates sharply; this is also the beginning of a new exchange rate cycle. Once the financial crisis is overcome, capital inflows increase again causing the appreciation of the national currency, the exchange

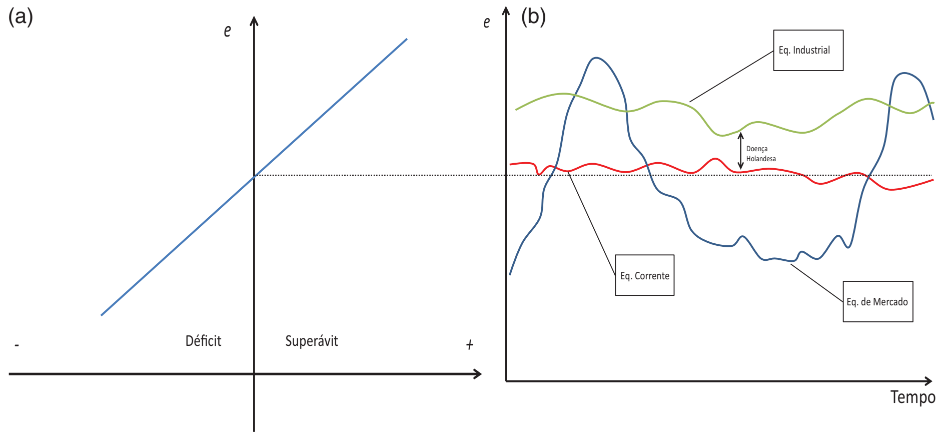

Figure 1. (a) Current account and the exchange rate. (b) Two equilibriums and the tendency.

rate crosses the industrial equilibrium and turns noncompetitive for the manufacturing industry, crosses the current equilibrium and enters the domain of the current-account deficit, and, finally, reaches a kind of bottom where only the more efficient commodity exporters are happy, and keeps there for a few years, while the country and its companies become increasingly indebted. Finally, the foreign creditors lose again confidence, capital inflows stop again, and a new financial crisis puts an end to the exchange rate cycle. Note that discussing the cyclical behavior of the exchange rate, I have been referring mostly to the current account, the capital flows entering the game to finance the current-account deficits. Wynne Godley (1999) showed and Richard Koo (2008) applied persuasively to the 2008 global financial crisis, the sectorial balances between the private, the foreign, and the public sector. They are crucial in the understanding of financial crises. Flow and stock are interdependent, the stock sectorial unbalance defining the crisis, and the flow unbalance leading to the former.

Capital inflows increase again once the financial crisis ends because the desired current-account deficits that derive from the high long-term interest rate (which derive from the two habitual policies) attract net capital inflows which will keep the interest rate high and the national currency overvalued (in relation to the exchange rate correspondent to a balanced current-account) for the time that the deficit is in place and an extra supply of foreign money will be required to finance it. As we see in Figure 1(a), there is a correspondence between the current-account balance and the exchange rate. The larger the deficit, the more appreciated the currency becomes. The vertical line in the middle of the figure indicates the point at which the current account is in equilibrium; is equal to zero. The sloped line, in turn, suggests the relationship between the current account balance and the exchange rate, the other variables remaining constant. In the figure, the long-term interest rate is constant. Any change in these variables will cause the curve to shift downward or upward.

Thus, the net capital inflows depend mainly on the long-term interest rate and the to the exchange rate cycle depend on two *habitual* policies adopted by developing countries–the growth with foreign indebtedness policy and the exchange rate anchor against inflation policy. Both policies are habitual in developing countries because policymakers in developing countries use them very often independently of their theoretical orientations. They determine the "long-term high interest rate", defined as the interest rate around which the central bank makes its monetary policy.

In this framework, the exchange rate is not just "volatile", or suffers from "misalignments". They are volatile and normally misaligned, but not in a random way. The volatility and the misalignments follow a cyclical pattern, according to the tendency to the cyclical and chronic overvaluation of the exchange rate. Developing countries follow a cyclical, going from financial crises to financial crises, intermediated by long-term periods in which the national currency is overvalued.

The Dutch Disease

The second "cause" of the long-term overvaluation of the exchange rate is the Dutch disease–a competitive disadvantage that blocks the industrialization or causes deindustrialization if the country previously neutralized the disease. There are in the economic literature two basic models: Corden and Neary (1982; Corden 1984) and Bresser-Pereira (2008). While the first model focuses on the three sectors that emerge from the disease (the commodity sector, the manufacturing sector, and the non-tradable sector), the second model focus in the exchange rate, the corresponding current account balance, and the two equilibriums: the current and the industrial equilibrium, which are in Figure 1(b). This model claims that the disease is the competitive disadvantage, which originates from the fact that Ricardian rents and/or commodity booms allow that the exports of commodities in a given country are competitive at an exchange rate (corresponding to the current equilibrium, which balances intertemporally the country's current account) substantially more appreciated than the exchange rate (the industrial equilibrium) that makes profitable the manufacturing industry that utilize the best technology available in the world. The severity of the Dutch disease depends on the distance between the two equilibrium values. I wrote "cause" at the beginning of this paragraph between quotes because the Dutch disease does not really appreciate the national currency but *shifts* the equilibrium exchange rate upside regarding the manufacturing industry.

Summing up, the value of the foreign money and the demand of supply of the same foreign money, which among other factors, depend on the long-term interest rate, determine the exchange rate. Besides the factors that determine in the short-term the interest rate, two habitual policies (the growth with foreign indebtedness policy and the use of the exchange rate as an anchor against inflation) determine a high long-term interest rate. Which, together with the value of the foreign money, and considering the tendency to its cyclical overvaluation, determine the exchange rate, and will produce the policy desired current-account deficit. If the country wants a competitive exchange rate, it will have to reject the two habitual policies and to balance its current-account or show a current account surplus if the country faces the Dutch disease. When the country faces de Dutch disease its exchange rate policy should make the exchange rate to float not around the current but around the industrial equilibrium, which, by definition, involves a current account surplus.

Against "Foreign Savings"

New developmentalism is critical of the growth with foreign indebtedness policy–to incur into current account deficits ("foreign savings") and finance them with loans or foreign direct investments–which is common to practically all economic theories. The first critique is well-known in the economic liberalism literature, the second is counter-intuitive. While it seems logical that capital-rich countries transfer their capitals to capital-poor countries, New Developmentalism argues that this thesis is generally false. We saw that a current account deficit requires additional capital inflows that keep overvalued exchange rate in the long-term (while the current-account deficit is in place). Thus, contrarily to the claim of the defenders of the growth with foreign indebtedness policy, the resulting overvaluation of the exchange rate coupled with a usually high marginal propensity to consume increases the acquisitive power of rentiers and wage-earners and, so, increases consumption, while it discourages investment. In other words, the increase in the supply of foreign money involves a high rate of substitution of foreign for domestic savings. Only at extraordinary moments this is not true: when the economy is already growing fast, and the ensuing high net expected profit rate causes a fall in the marginal propensity to consume and a paired increase in the marginal propensity to invest. New developmentalism is also critical of the habitual policy of using the exchange rate as a nominal anchor to control inflation. Note that the empirical research confirming this counter-intuitive inverse relation between foreign savings and domestic savings, and, so, between current account deficits and growth: Bresser-Pereira and Nakano (2003), Bresser-Pereira and Gala (2008), Bresser-Pereira, Araujo, et al. (2014). See also Feldstein and Horioka (1980), which economists call a "puzzle" but is just the empirical confirmation of the substitution of foreign for domestic savings, as is also the case of the empirical studies on "savings replacement": Sinn (1992), Coakley, Kulasi, and Smith (1996).

Afraid of currency crises, conventional policymakers may search to limit current-account deficits. Although believing the growth with foreign indebtedness policy is a good policy, they define a limit for it: that does not cause the foreign debt-GDP ratio to grow. New developmentalism rejects this view. Even when the current-account deficit does not lead the country to financial crisis, it will be harmful to the country in so far that the ensuing additional capital inflows appreciate in the long-term the national currency and makes its competent manufacturing companies noncompetitive.

Currency Crises

Currency crises play a major role in harming economic development. New developmentalism shares this view but is critical of the currency crises models which dominate conventional economics–the models that make the balance of payment crisis a function of excessive fiscal expending, which cause increase in imports, current account deficits, and the suspension of the rollover or the foreign debt (Krugman 1979, 1999). For New

Developmentalism, currency crises may have such origin, since fiscal populism is a recurrent problem. However, it can have a more direct cause, which is often independent of the budget deficit: the growth with foreign indebtedness policy. In many cases, the fiscal accounts are under control, but the private accounts either of the enterprises or the households are not, and the country incurs in high current account deficits. These deficits don't worry conventional policymakers because they wrongly believe that additional foreign savings will mean additional total savings and investments. But, as we've seen already, most of the time this is false. What is sure is that chronic current account deficits appreciate the national currency in the long-term, and the accumulation of current account deficits leads necessarily to an excessive debt of firms, households and the state, in various intensities, which represent macroeconomic maladjustment and lead, sooner or later, to a financial crisis.

The market solution for the lack of macroeconomic adjustment due to current account deficits is the exchange rate devaluation. An alternative is "internal devaluation", like the one that was required from the "South" countries in the euro crisis (2010–2016).[3] Since these countries had no national money to depreciate, they adopted a severe fiscal austerity program that caused recession, unemployment and the fall of real wages, thus recovering their competitiveness. However, in countries that have their national currency and may depreciate it, we often have just an "internal adjustment". Facing a macroeconomic maladjustment, the state makes only the fiscal adjustment, leaving the nominal exchange rate untouched in so far that it does not renounce to the three habitual policies. In this case, the adjustment cost falls only to the workers, who lose their jobs or see their wages fall in real terms, while the revenues of rentiers remain protected.

Two Economic Populisms

We are now ready to discuss the macroeconomic policies that derive from this theoretical framework. To achieve stability and growth, the government should, on one side, assure that the two main accounts, the fiscal and the foreign accounts are under control, and, on the other hand, it should keep the five macroeconomic prices right. I will begin with the two accounts.

New developmentalism defends a responsible fiscal policy–essentially the achievement of public savings that finance partially public investments (a budget deficit may complement such financing) of around 20 percent of GDP. A primary surplus that keeps the public indebtedness on a comfortable level is also required but the government should not achieve it by cutting public investments. The fiscal policy should be rigorously countercyclical, expanding in recession and contracting in the booms. Since New Developmentalism assigns a major role to the state in coordinating the economic system complementarily to the market, it reclaims a capable state–a developmental state able to perform its main economic roles. A capable state cannot be a broken state.

New developmentalism also defends a balanced foreign account. Given that a current account deficit will evaluate the exchange rate, the objective should be a balanced current account. However, if the country faces the Dutch disease, the objective should be a current account surplus, because the neutralization of the Dutch disease will involve a shift from the current to the industrial equilibrium which will necessarily correspond to a surplus. The size of the current account surplus in relation to GDP will depend on the severity of the disease, on how far the current and the industrial equilibriums are apart.

New developmentalism is critical of *economic* populism, either on the well-known form of fiscal populism (the state spending irresponsibly more than it gets–not exhibiting budgetary discipline) or on the form of exchange rate populism (the nation-state spending irresponsibly more than it gets by engaging into current account deficits). Economic populism should not be confused with political populism–the political practice of nationalist political leaders that achieve a direct relationship with the people without the intermediation of political parties and established ideologies. Populist political leaders are not necessarily economic populists as they may be disciplined in fiscal and in exchange rate terms. Liberal orthodoxy ends up being populist regarding the exchange rate because it defends current account deficits as foreign savings which increase total savings instead of replacing domestic savings. When developmental policymakers are populist, they usually make the two mistakes. Fiscal and exchange rate populism imply an increase in real revenues and consumption; exchange rate populism means, additionally, discouragement of investment.

Note that, by identifying current account deficits with exchange rate populism and rejecting the growth with foreign indebtedness policy, New Developmentalism does not reject the multinational enterprises. They are welcome, but not to finance current deficits, but to bring technology, or to open new markets. China, which does not suffer from the Dutch disease, did not register a current account deficit since its liberalized trade and started growing incredibly fast. If to reject current-account deficits was right to China, it will be righter to other developing countries that export commodities and, so, should have a higher current account surplus. The manufacturing industry may be the origin of Dutch disease on two conditions: that it is very unsophisticated, with low value added per capita, and that the difference between the salaries of the plant engineers and the workers in the country is substantially bigger than in rich countries.

The Right Exchange Rate

Let us now move to the macroeconomic prices. They must be kept "right"–this not meaning that right prices are the ones markets define, as liberal orthodoxy assumes, but because they assure growth and stability. The right profit rate is the satisfying rate, the rate that motivates companies to invest.

The right interest rate (around which the central bank manages its monetary policy) is a relatively low-level interest rate; it is an interest rate which is above the international interest rate just in function of the country risk differences. High interest rates contribute negatively to the investment and growth rates of the country, while increases its public debt to GDP ratio.

The right exchange rate is the rate that makes competitive the companies that are administratively and technologically capable; it will float around the industrial equilibrium. To keep the exchange rate competitive, New Developmentalism proposes that developing countries do not incur in current-account deficits, which will increase the capitals inflows and turn overvalued the national currency; and rejects the use of the exchange rate as an anchor against inflation. Besides, the government may have to adopt capital controls. In principle, if the country presents a balanced current account, or a current account surplus, it would not need capital controls, but financial markets are highly unstable and speculative, and the possibility of controlling capital inflows and capital outflows must always be open. In 2016, for instance, despite its enormous reserves and enduring current account surpluses, China faced a considerable capital outflow and adopted capital controls.

How to neutralize the Dutch disease? Since a neutralized Dutch disease floats around the industrial equilibrium, and this equilibrium is expressed in value or cost of production, not in price terms, a variable export tax on the commodities that originate the disease will duly increase the cost of production and neutralize the disease. The tax is supposed to be variable because the severity of the disease changes due to the variations in the commodities' international prices. Who pays for this export tax or retention? Not the commodity producers, because they get back on the form of exchange rate what they paid as tax, but the population (the workers, the salaried middle-class and the rentiers and financiers). Only the manufacturing companies don't pay for the policy; on the contrary, they benefit from it, because the objective is to give them equal conditions of competition with companies of other countries.

Microeconomic Policy

Besides keeping balanced the two macroeconomic accounts and right the five macro prices New Developmentalism defends a microeconomic policy based on distinguishing within national economies a competitive and a noncompetitive sector. For the competitive sector, the market is by far the more efficient coordinative institution. Industrial policy should complement the market action, but governments should not use it as compensation to an overvalued currency. As to the noncompetitive sector, the only alternative is economic planning. We may find industries that are in a gray area between the competitive and the noncompetitive sector. Industrial policy makes sense in this case.

Finally, New Developmentalism defends an export-led and a profit-led growth strategy. In Post-Keynesian Economics there is a debate between a profit-led and a wage-led strategy since Bhaduri and Marglin (1990) on the theme, but, as duly emphasized by Anwar Shaik (2017), in his remarkable book, Capitalism–Competition, Conflict, Crises, the classical political economy of Smith and Marx is profit led, and New Developmentalism follows, because the net expected profit rate determines investment. On the other hand, there is also a debate on the export-led versus domestic-led strategy, but the later only makes sense if the country adopts an import substitution strategy, and we know that this is a dated strategy. Due to the economies of scale constraint, it only makes sense in the very beginning of industrialization.

The Interests behind

The economic policies summarized in the last two sections involve distributional problems. The once and for all depreciation advocated by New Developmentalism leads to a reduction in real wages and salaries, as well as in rentiers' real interests, dividends, real-estate rents. This explains why liberal economists, who usually represent the interests of rentiers and financiers, as well as populist developmental economists, who believe to serve the interests of wage and salary earners, usually oppose exchange rate depreciation. New developmentalism opposes the *austerity* fiscal programs defended by liberal orthodoxy because the burden of this type of macroeconomic adjustment falls just on the workers, as the ensuing recession and the unemployment reduce their real wages. It would also fall on the rentiers if it also involved an exchange rate adjustment, which, besides reducing the acquisitive power of workers, has the effect on the rentier rents (interests, dividends and real-estate rents). New developmentalism defends both fiscal and exchange rate adjustment to achieve a faster and less biased adjustment. On the other hand, it rejects the vulgar understanding that fiscal adjustment is a conservative policy, while fiscal expansion would be Keynesian and progressive. Given the same macroeconomic maladjustment, the new-developmental budgetary adjustment will be in principle less severe. If the adjustment is only fiscal but is supposed to recover the foreign competitiveness of the country, this will only be obtained if the fiscal adjustment (and the ensuing unemployment and fall on wages) is substantially bigger than if it was coupled with an exchange rate adjustment. A more reasonable policy is to make the two adjustments together. Actually, the rentiers, including a rentier and salaried high middle-class, and the orthodox economists are *less* interested in a competitive exchange rate, or, in other words, they are more hostile to depreciations than workers. While their dividends, real-estate rents, and interests lose the same acquisitive value that the wages lose, their wealth falls. Moreover, keeping the exchange rate competitive requires a permanently lower level interest rate around which the central bank performs its monetary policy–-something that rentiers and financiers repel.

New-developmental defends a relatively high tax burden to finance the large social services of the welfare state but rejects its increase to keep the fiscal account sound *after* the deficit materialized. It defends also managerial public reforms that make the large social services of the welfare state more efficient or less costly, with the argument that such cost reduction legitimizes a form of state that is already *intrinsically* efficient, it is a form of collective consumption; the alternative (private consumption) is substantially costlier. Take, for instance, health care. In the US, health care is essentially private, and costs 17 percent of GDP; in the Western European Countries, it is public, universal, and cost only 11 percent of GDP.

As to Dutch disease and the commodity exporters, who are supposed to pay the variable export tax that neutralizes it, they may eventually accept such tax provided that the government warrants the devaluation will compensate it, and their business will remain profitable and secure. This compensation will follow from the market, but, if at the same time, the three habitual policies that appreciate the national currency via interest rate are not permanently rejected, they will suffer losses, and will feel cheated. This happened in Argentina, when, in the 2001 major financial crisis, the government created an export tax, which, initially, the devaluation of the peso fully compensated. However, from 2007, given the rise of inflation, the government used the exchange rate as an anchor to control inflation. The ensuing appreciation of the peso turned the commodity exporters indignant, while the manufacturing industry lost competitiveness, and fast growth was over.

Finally, the right wages are the wages that, supposing technical progress is neutral, increase with productivity, being so consistent with a satisfying profit rate, and the right inflation rate is a small one–indeed one-digit inflation.

New developmentalism has a distributive policy that I summarize here: (a) ensuring a decent minimum wage, (b) increasing the tax burden to build a large social or welfare state based on public education and public universal health care, (c) turning it progressive, (d) creating or maintaining a reasonable protection for labor contracts, and (e) keeping the interest rate as small as possible. The difference between the distribution in the Scandinavian countries and the United States, between the most equal and the most unequal rich countries, does not happen before taxes, but *after* them. In the United States, President Franklin Delano Roosevelt created a progressive tax system, but, from the 1980s' neoliberal turn, the successive administrations dismantled it and made the United States an unequal country and a divided society.

Comparisons

I end this paper with some summarizing comparisons. First, how to compare New Developmentalism with Development Economics or Classical Developmentalism? The chief differences are: (1) Classical Developmentalism's principal object are the pre-industrial countries, while for New Developmentalism, the middle-income countries, which have already realized their industrial and capitalist revolution; (2) Classical Developmentalism didn't count with a macroeconomics and reproduced Post-Keynesian Macroeconomics,[4] while New Developmentalism counts with a relatively developed macroeconomics; (3) Classical Developmentalism was pessimist in relation to the developing countries' ability to export manufactured goods, and defended an import substitution strategy, while New Developmentalism assumes that middle-income countries are able and should export manufactured goods; yet, this pessimism concerning exports of manufactured goods proved wrong soon; in the 1970s, East Asian countries, Brazil and Mexico started exporting them and were called NICs: Newly Industrialized Countries; (4) Classical Developmentalism defended the growth with current-account deficits and foreign indebtedness policy, while New Developmentalism rejects it; (d) Classical Developmentalism was skeptical about an exchange rate policy, preferring high tariffs, while New Developmentalism gives to the exchange rate policy a significant role in assuring to the national companies equal conditions of competition.

Second, the brief comparison of New Developmentalism, not with Neoclassical Economics, but with the liberal orthodoxy (the views and policies based on Neoclassical Economics or in Austrian Economics): (1) liberal orthodoxy adopts a hypothetical-deductive method that starts from some economic axioms to deduce under the form of syllogistic models the whole, while New Developmentalism uses a historical-deductive method where the observation of regularities and tendencies and the definition of historical models have priority over syllogistic economic models; (2) liberal orthodoxy assumes that a country may develop without industrializing, while New Developmentalism views growth as productive sophistication, which countries achieve by transferring labor to increasingly sophisticated activities, which pay high wages, and have more value added per capita; (3) liberal orthodoxy assumes that if the fiscal account is kept balanced, the macroeconomic system will also be, while New Developmentalism argues that the market is unable to keep the macroeconomic prices right, particularly the exchange rate, and defends a much more active and encompassing macroeconomic policy; (4) while liberal orthodoxy does not consider the exchange rate in the investment function, New Developmentalism sees it as an essential variable as it gives or denies to the competent companies access to demand; (5) while the liberal orthodoxy explains financial crises with fiscal indiscipline, New Developmentalism does not discard this possible cause but argues that the growth with current-account deficits and foreign indebtedness (the so-called "growth with savings policy") is the primary cause of financial crises of developing countries.

Third, considering "conventional economics", i.e., the basic economics shared by most economic schools of thought:

1. New Developmentalism sees the growth with foreign indebtedness policy as self-defeating because the additional supply of capital inflows to finance the current-account deficit will appreciate the currency, increase consumption, reduce the competitiveness of the local companies, and discourage investment;
2. the main cause of the high long-term interest rate around which the central banks conduct their monetary policy are the habitual policies of attracting foreign capitals and o using the appreciation of the national currency as an anchor against inflation; as New Developmentalism works with historical economic agents who act in some regular or predictable way, they are not only producers and consumers, workers and companies; policymakers are also considered as their policies follow a certain regularity–are habitual policies;
3. the main cause of the overvalued long-term exchange rate is the high long-term interest rate usually prevailing in developing countries;
4. New Developmentalism has an original model explaining the Dutch disease from which it derives the policy to neutralize it.

Notes

1. For a general view of New Developmentalism (Bresser-Pereira 2010, 2016) and (Bresser-Pereira, Oreiro and Marconi 2016). This is the Portuguese version of the book; I am quoting it instead of its English version (2014) because, as New Developmentalism is a work in progress, the Portuguese edition is superior.
2. Positive relation between the exchange rate and growth (Razin and Collins 1997; Gala 2007; Rodrik 2008; Rapetti, Skott and Razmi 2012; Missio, Jayme, Britto and Oreiro 2015). Dani Rodrik built an index of real exchange rate undervaluation for several countries based on Penn World Tables which he adjusted for the Balassa-Samuelson effect. (Gala 2006) in his PhD dissertation at the São Paulo School of Economics of Getúlio Vargas Foundation, was only able to show the relative depreciation of the currencies of the East Asian countries when his adviser proposed he adjusted his data for the same Balassa-Samuelson effect.
3. See (Bresser-Pereira and Rossi 2015).
4. The only macroeconomic contribution of Classical Developmentalism was the "structural inflation hypothesis" – the claim that inflation in developing countries would be consequence of structural bottlenecks in the supply of agricultural goods. But this condition only applies in the very beginning of the growth process.

ORCID

Luiz Carlos Bresser-Pereira http://orcid.org/0000-0001-8679-0557

Further Reading

Amsden, Alice H. 1989. *Asia's Next Giant*. New York: Oxford University Press.

Bhaduri, Amit, and Stephen Marglin. 1990. "Unemployment and the Real Wages: The Economic Basis for Contesting Political Ideologies." *Cambridge Journal of Economics* 14 (4):375–393. doi: 10.1093/oxfordjournals.cje.a035141.

Bresser-Pereira, Luiz Carlos. 2011. "From the National-Bourgeoisie to the Dependency Interpretation of Latin America." *Latin American Perspectives* 38 (3):40–58. doi:10.1177/0094582X10391064.

Bresser-Pereira, Luiz Carlos, and Paulo Gala. 2008. "Foreign Savings, Insufficiency of Demand, and Low Growth." *Journal of Post Keynesian Economics* 30 (3):315–334. doi: 10.2753/PKE0160-3477300301.

Bresser-Pereira, Luiz Carlos, and Pedro Rossi. 2015. "Sovereignty, the Exchange Rate, Collective Deceit, and the Euro Crisis." *Journal of Post Keynesian Economics* 38 (3):355–375. doi: 10.1080/01603477.2015.1087807.

Bresser-Pereira, Luiz Carlos, and Yoshiaki Nakano. 2003. "Economic Growth with Foreign Savings?" *Brazilian Journal of Political Economy* 22 (2):3–27.

Bresser-Pereira, Luiz Carlos, Eliane Araujo, and Paulo Gala. 2014. "An Empirical Study of the Substitution of Foreign for Domestic Savings in Brazil." *EconomiA* 15 (1):54–67. doi: 10.1016/j.econ.2014.04.00.

Bresser-Pereira, Luiz Carlos, José Luis Oreiro and Nelson Marconi 2014. *Development Macroeconomics*. London: Routledge.

Bresser-Pereira, Luiz Carlos, José Luis Oreiro and Nelson Marconi 2016. *Macroeconomia Desenvolvimentista [Developmental Macroeconomics]*. Rio de Janeiro: Campus/Elsevier.

Bresser-Pereira, Luiz Carlos. 2008. "The Dutch Disease and Its Neutralization: A Ricardian Approach." *Revista de Economia Política* 28 (1):47–71. doi: 10.1590/S0101-31572008000100003.

Bresser-Pereira, Luiz Carlos. 2010. *Globalization and Competition*. New York: Cambridge University Press.

Bresser-Pereira, Luiz Carlos. 2016. "Reflecting on New Developmentalism and Classical Developmentalism." *Review of Keynesian Economics* 4 (3):331–352. doi: 10.4337/roke.2016.03.07.

Bresser-Pereira, Luiz Carlos. 2019. "Why Did Trade Liberalization Work for East Asia but Fail in Latin America?" *Challenge* 62 (4):273–277. doi: 10.1080/05775132.2019.1632526.

Cardoso, Fernando Henrique, and Enzo Faletto. 1969(1979). *Dependency and Development in Latin America*. Berkeley: University of California Press. (Original Spanish edition, 1969).

Chang, Ha-Joon. 2002. *Kicking Away the Ladder*, London: Anthem Press.

Coakley, Jerry, Farida Kulasi, and Ron Smith. 1996. "Current account Solvency and the Feldstein-Horioka Puzzle." *The Economic Journal* 106 (436):620–7. doi: 10.2307/2235567.

Corden, W. M. 1984. "Booming Sector and Dutch Disease Economics: Survey and Consolidation." *Oxford Economic Papers* 36 (3):359–80. doi: 10.1093/oxfordjournals.oep.a041643.

Corden, W Max, and J Peter Neary. 1982. "Booming Sector and De-Industrialisation in a Small Open Economy." *The Economic Journal* 92 (368):825–48. doi: 10.2307/2232670.

Feldstein, Martin, and Charles Horioka. 1980. "Domestic Saving and International Capital Flows." *The Economic Journal* 90 (358):314–329. doi: 10.2307/2231790.

Frank, Andre Gunder. 1966. "The Development of Underdevelopment." *Monthly Review* 18 (4):17–31. doi: 10.14452/MR-018-04-1966-08_3.

Gala, Paulo. 2006. “Política Cambial e Macroeconomia do Desenvolvimento [Exchange Rate Policy and Development Macroeconomics]”, PhD diss., Escola de Economia de São Paulo da Fundação Getúlio Vargas. http://hdl.handle.net/10438/1782.

Gala, Paulo. 2007. “Real Exchange Rate Levels and Economic Development: theoretical Analysis and Econometric Evidence.” *Cambridge Journal of Economics* 32 (2):273–288. doi: 10.1093/cje/bem042.

Godley, Wynne. 1999. *Seven Unsustainable Processes–Medium-Term Prospects and Policies for the United States and the World” – Special Report*. Annandale-on-Hudson, NY: Jerome Levy Economics Institute.

Hirschman, Albert O. 1958. *The Strategy of Economic Development*. New Haven: Yale University Press.

Johnson, Chalmers. 1982. *MITI and the Japanese Miracle*. Stanford: Stanford University Press. doi: 10.1086/ahr/88.1.158.

Koo, Richard C. 2008. *The Holy Grail of Macroeconomics: Lessons from Japan’s Great Recession*. New York: Wiley.

Krugman, Paul. 1979. “A Model of Balance of Payments Crises.” *Journal of Money Credit and Banking* 11 (3):311–325. doi: 10.2307/1991793.

Krugman, Paul. 1999. “What Happened to Asia?” In Ryuzo Sato, Rama V., Ramachandran, Kazuo Mino. *Global Competition and Integration*, Norwell, MA: Kluwer Academic Press; 315–327.

Lewis, Arthur W. 1954. “Economic Development with Unlimited Supply of Labour.” *The Manchester School* 22 (2):139–191. doi: 10.1111/j.1467-9957.1954.tb00021.x.

Missio, Fabrício J, Frederico G. Jayme, Gustavo Britto, and José Luis Oreiro. 2015. “Real Exchange Rate and Economic Growth: New Empirical Evidence.” *Metroeconomica* 66 (4): 686–714. doi: 10.1111/meca.12087.

Prebisch, Raúl. 1949(1950). *The Economic Development of Latin America and Its Principal Problems*. New York: United Nations, Dept. of Economic Affairs (Original Spanish publication, 1949).

Rapetti, Martín, Peter Skott, and Arslan Razmi. 2012. “The Real Exchange Rate and Economic Growth: Are Developing Countries Special?” *International Review of Applied Economics* 26 (6): 735–753. doi: 10.1080/02692171.2012.686483.

Razin, Ofair, and SusanM. Collins. 1997. *Real Exchange Rate Misalignments and Growth*. Working Paper 6174, September. National Bureau of Economic Research, Cambridge, MA.

Reinert, Erik S. 2007. *How Rich Countries Got Rich … and Why Poor Countries Stay Poor*. New York: Carroll and Craf.

Rodrik, Dani. 2008. “Real Exchange Rate and Economic Growth.” *Brooking Papers on Economic Activity* 2 (Fall):365–412.

Rosenstein-Rodan, Paul. 1943. “Problems of Industrialization in Eastern Europe and South-Eastern Europe.” *The Economic Journal* 53 (210/211):202–11. doi: 10.2307/2226317.

Shaikh, Anwar. 2017. *Capitalism – Competition, Conflict, Crises*. New York: Oxford University Press.

Sinn, Stefan. 1992. “Saving-Investment Correlations and Capital Mobility: On the Evidence from Annual Data.” *The Economic Journal* 102 (414):1162–1170. doi: 10.2307/2234383.

Wade, Robert. 1990. *Governing the Market*. Princeton: Princeton University Press.