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Why the 'Rest' doesn't need foreign finance

Luiz Carlos Bresser-Pereira

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Abstract: The Rest will be able to catch up and grow faster than the West only if it goes against a "received truth", namely that capital-rich countries should transfer their capital to capital-poor countries. This intuitive truth is the mantra that the West cites to justify its occupation of the markets of developing countries with its finance and its multinationals. Classical Developmentalism successfully criticized the unequal exchange involved in trade liberalization, but it didn't succeed in criticizing foreign finance. This task has been recently achieved by New Developmentalism and its developmental macroeconomics, which shows that countries will invest and grow more if they don't run current account deficits, even when these deficits are financed by foreign direct investment.

Key words: foreign savings, domestic savings, Dutch disease, foreign finance, developmentalism

JEL classification: O11, O24, E2, F3.

The relations between the West and the Rest, between the center and the periphery of capitalism, were always difficult. They originally assumed the form of colonial domination: mercantile domination of Latin America, mainly by Spain and Portugal, between the 16th and the 18th centuries; and industrial domination of Asia and Africa, mainly by Britain and France, in the 19th century and the first half of the 20th century, as the industrial revolution in Europe made these countries strong enough to subjugate the old empires of these two continents. As colonized countries achieved independence – the Latin American ones in the early 19th century, the others after World War II – domination remained, but now relied on the West's soft power and on the dependency of the local elites.

After World War II, it was clear that the world had been divided between the West – the rich countries – and the Rest – the developing countries. With the theoretical support of a school of thought that emerged at this time – namely development economics – the countries where the elites had been mostly nationalist in economic terms criticized the law of comparative advantage, adopted a developmental strategy, neutralized the Dutch disease when they contracted it,¹ and industrialized; and, after the 1970s, the more successful ones – the newly industrialized countries (NICs), that is, the four Asian tigers (Hong Kong, Singapore, South Korea, and Taiwan) and Brazil and Mexico – began to export manufactured goods to the West, actively competing with it. Soon other Asian countries, including China and India, successfully joined the competition,

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and the world economy changed. It ceased to be a world only of rich and pre-industrial countries, and became a world also of middle-income or emerging countries exerting pressure on the West. Today, the more successful ones – South Korea, Taiwan and Singapore – are already rich.

All successful cases of development among the Rest involved economic nationalism or a developmental strategy whereby the manufacturing sector was protected up to the moment it ceased to consist of infant industries.² No industrial revolution in these countries was achieved while their states were liberal; their states were always developmental, combining market coordination with moderate but firm government intervention. All of them privileged national business enterprises over foreign ones.

Yet the Rest's intellectuals and politicians failed to criticize foreign finance. They failed to recognize that in most cases a country would grow faster and with more stability if it avoided current account deficits that would have to be financed either by loans or by the direct investments of multinational enterprises. Many of the intellectuals joined forces with left-wing economists who since the 1990s had been criticizing "financialization" – the speculative action of financiers searching to multiply the gains of rentier capitalists through financial innovations that involve leverage increase and fraud – but financialization is a general problem of capitalism as a whole. It was the main cause the 2008 Global Financial Crisis. What the Rest's economists have failed to do is to criticize the *received truth* that resorting to foreign indebtedness is a good way to achieve growth: the idea that current account deficits should be welcomed because these "foreign savings" increase the investment rate of the country, provided that they are financed by direct investment or by loans formally attached to investments. For sure, developing countries need finance, but domestic finance – not only for short-term commercial activities but mainly for investment and exports, particularly exports of manufactured goods. Domestic private banks satisfactorily finance day-to-day commerce; public banks should be set up to finance investment and exports.

Since the 19th century developing countries have turned to foreign banks for finance in hard currency and have experienced currency crises, usually caused by increases in foreign debt associated with falling commodity prices. The World Bank was set up after World War II to rescue the European countries and to offer finance to developing economies. It was then that the strategy of "growth cum foreign savings" was "officially" adopted. At this time, the 1950s, *classical developmentalism* – the version of development economics that originated in Latin America and whose main advocates were Raúl Prebisch and Celso Furtado – was able to criticize "unequal exchange" but unable to criticize foreign finance. On the contrary, from its foundation text (Rosenstein-Rodan's 1943 paper on the "big push"), development economics relied on foreign capital to promote economic growth. It is true that some economists, such as Ragnar Nurkse, maintained that "capital is made at home", but this didn't represent a critique of growth with current account deficits to finance loans or direct investment. At that time, developmental economists criticized investment by multinationals in the exploitation of mineral resources and bananas, which created modern enclaves in pre-industrial societies and involved large profit remittances to the

West. But they made no critique of the multinational corporations that, to circumvent the barriers imposed by developing countries, began to invest directly in manufacturing industry from the 1950s on. On the contrary, a number of them understood that such investment refuted the contention of economic nationalism (or developmentalism) that the rich countries opposed the industrialization of the periphery, and moved from classical developmentalism to economic liberalism. Indeed, the West is not opposed to the industrialization of the Rest since such industrialization is carried out by multinational corporations.

Economic liberalism proposes an intuitively rational argument in favor of the policy of growth cum foreign indebtedness, namely that “capital-rich countries should transfer their capital to capital-poor countries”. This is an argument in favor of current-account deficits and financing them either by long-term loans or by direct investment. But although this argument seems to be true, it is in fact false because, as we show below, it ignores two facts: (a) that a current-account deficit is consistent with an overvalued currency that discourages domestic investment, and (b) that when a country duly neutralizes its Dutch disease, it will have a current account surplus consistent with the resulting competitive exchange rate. The argument for growth cum foreign indebtedness serves the interests of the West but not the interests of the Rest, except under certain special conditions. I maintain that developing countries will grow faster and catch up if they achieve current-account balance or surplus. In this paper my objective is to discuss this issue – an issue rarely debated by economists – and to offer an argument against current account deficits. I will argue that developing countries (other than very poor ones) *don't need* foreign capital, and so should avoid current-account deficits and any recourse to foreign finance. They may accept direct investment because it brings technology or because it opens new markets, but not because it brings capital.

I am not making an argument against domestic finance. Such finance is essential to economic development, whether in Schumpeterian terms, whereby the business entrepreneur has credit and innovates, or in Keynesian terms, whereby the investment, duly financed, determines savings. And I am not making an argument against multinationals so long as their legitimacy is based on technology transfer and the generation of exports, not on the financing of current account deficits.

Some evidence

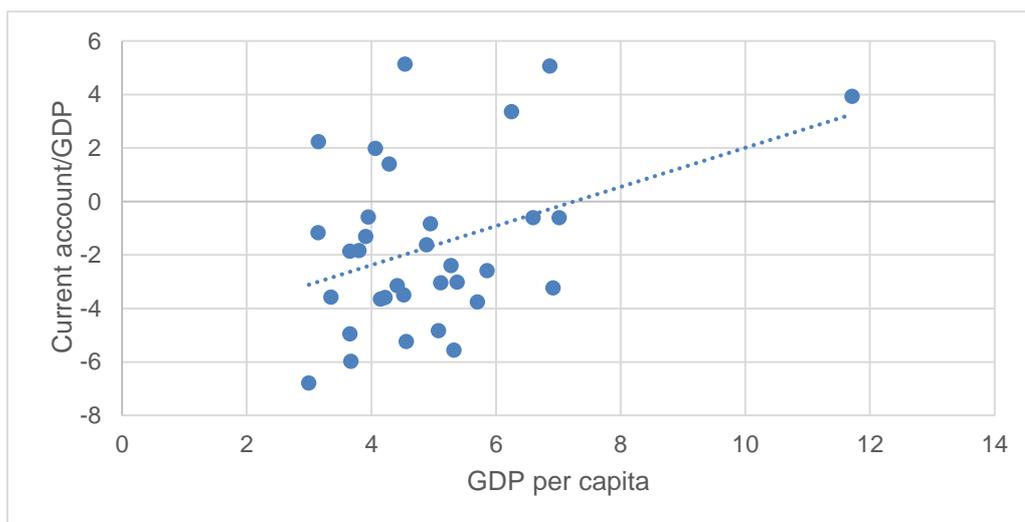
This paper is analytical rather than empirical. It assumes that there is already enough evidence to show that, in most cases, developing countries don't need foreign finance in order to grow. A very simple way of confirming this fact is to show that the countries that run current-account deficits and so resort to foreign finance usually grow less than if they achieve current-account balance or surplus. In other words, the greater a developing country's current account deficit, the more slowly it grows. A simple demonstration is presented in Figure 1, which shows the relation between current-account deficits and per capita economic

growth in a sample of middle-income countries with per capita purchasing parity (PP) incomes of more than US\$10,000, other than oil exporters, between 1981 and 2007. The tendency line has a clear upward slope, confirming the negative relation between current-account deficits and growth. The majority of the middle-income countries run current-account deficits, but the smaller they are, or the greater their current-account surpluses are, the faster they grow. This finding challenges the conventional wisdom, whose advocates will certainly argue that the data in Figure 1 are not enough to establish definitively an inverse relation between foreign savings and growth. I agree, but the data are a good indication.

In Figure 2 we have the other developing countries, those with per capita PP incomes of below US\$10,000, other than oil exporters and diamond exporters, between 1981 and 2007. As expected, the relation is less clear because foreign capital may assist countries in the earliest stages of capitalist development, but even here the same tendency is evident.

Figure 1: Per capita income growth and current account in middle-income countries (1981-2014)

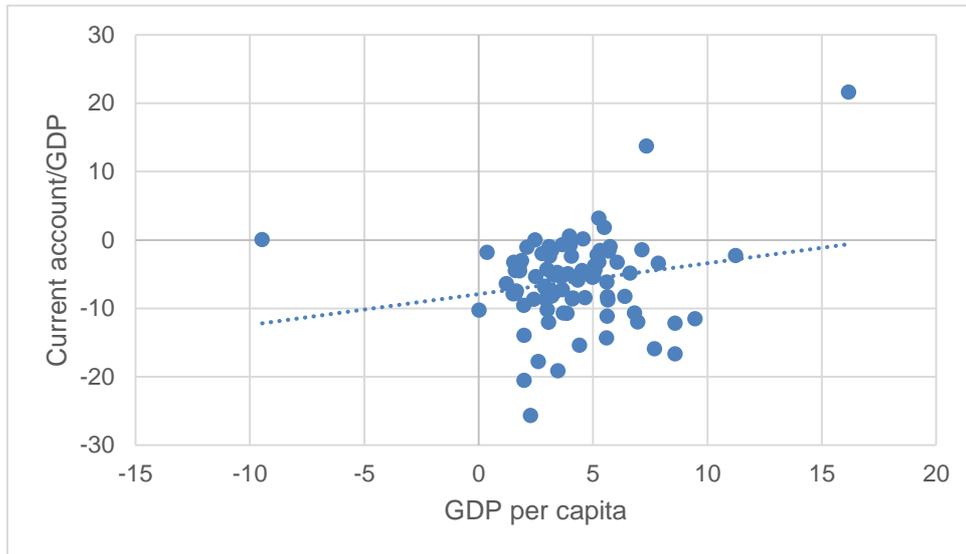
(PP income per capita above US\$10,000, except oil exporters)



Source: World Bank

Figure 2: Per capita income growth and current account in developing countries (1981–2014)

(PP income per capita below US\$10,000, except oil and diamond exporters)



Source: World Bank.

There is further evidence of the inverse relationship between current-account deficits and growth, beginning with the so-called “Feldstein–Horioka puzzle” (1980) – the realization on the part of these two distinguished economists that domestic savings rates and domestic investment rates are highly correlated in the OECD countries, which refutes the belief that the savings of any country will flow to those countries with the most productive investment opportunities. In my first paper on the theme (Bresser-Pereira and Nakano 2003) a clear inverse relationship is demonstrated between foreign savings and growth; in relation to Brazil, Bresser-Pereira, Araújo and Gala (2014) verified a clear substitution of foreign for domestic savings. And there is a large literature on “savings displacement” – that is, the displacement of domestic savings by foreign savings – whose findings essentially corroborate this substitution and, so, the inverse relation between foreign savings and growth.³

The conventional argument

In the original studies on economic development, undertaken just after World War II, the assumption was that developing countries, at that time called “underdeveloped countries”, were pre-industrial or pre-capitalist countries that lacked capital. Thus, there was a primitive accumulation problem: where did the initial investment originate? In a purely traditional society, it could originate only from abroad. If it was already exploiting certain natural resources which

complemented Europe's natural resources, the original accumulation could be domestic. That happened in most Latin American countries and, in a different way, in the Asian countries where previous civilizations, mostly destroyed in the colonial period, had somehow accumulated some capital. These countries enjoyed what came to be called "Ricardian comparative advantage", but, actually, what they produced could not be produced in the West for reasons of climate or of natural resource availability.

In this case, there were two possibilities: either the local elites had been able, over the centuries, to achieve primitive accumulation domestically by exporting agricultural goods, as in most of Latin America; or foreign firms took charge of this task, investing mostly in mining but also in agriculture, as in many African countries from the 19th century. Yet there was also a third possibility, associated with East Asian countries, which proved more fruitful: the country did not count with natural resources to export commodities, but the pre-existing traditional system had developed a domestic market and an education system that served as instruments for a short-lived import substitution model of industrialization, soon followed by the export of manufactured goods.

Thus, only in the second of these three cases set out above did foreign finance play a significant role. Nevertheless, economic theory always assumed that foreign capital was essential to growth in all developing countries. The conventional argument in favor of growth cum foreign savings and, so, in favor of foreign finance is simple and straightforward. And naturally it ignores historical and natural resource problems. Growth depends on investment, I , which is equal to total savings, S , which is equal to domestic savings, S_d , plus foreign savings, S_x . Domestic savings are by definition and necessarily insufficient. Thus, when a country obtains foreign savings, its total savings and total investments will be proportionally higher, and growth will accelerate. The only problem with this argument is that it involves not economic but *accounting* reasoning, not *ex ante* but *ex post* reasoning. The accounting argument does not consider that, *ex ante*, investment can be higher or lower than savings; that foreign savings don't necessarily add to domestic savings but may substitute for them. I come back to this problem later.

Developing countries are taught that they should increase their savings and investment capacity, and that the best way to do this is to run current-account deficits, supposedly caused by increased investment, and finance them with foreign loans. Actually, the West explains, this is a second best, because there is no guarantee that the loans will finance additional investment rather than additional consumption. But there would be an obvious first best – foreign direct investment finance – because in this case it would not be possible to use the additional financial resources to finance consumption.

For sure, the country will have to pay interest on the additional foreign debt, or profit remittances on the additional foreign direct investment; but in the case of loans, the argument goes, the country should reason as individual business enterprises do: provided that the interest rate is lower than the rate of return on the additional investment, the country will grow faster and will not have any difficulty in paying its debts and in keeping its foreign account in balance. I

remember hearing this argument again and again in the second half of the 1970s, when Brazil decided to grow with foreign savings. And I also remember how terrible its consequences were in the following decade, when the countries with high foreign debt, “led” by Brazil, faced a huge financial crisis – the foreign debt crisis of the 1980s.

Actually, foreign finance, in the form of portfolio investment and especially foreign direct investment, is essentially *in the interests* of the West. It is something key to the foreign policy of the United States and the other rich Western countries, which send much more investment abroad than they receive into their territories, and thus occupy without direct reciprocity the domestic markets of developing countries. When we examine the bilateral “trade” agreements that the United States signs with other countries, or the multilateral agreements that the United States has signed on one hand with Europe and on the other with Pacific countries, we see that they are not really trade agreements, in so far as tariffs are already quite low. The real objectives of these agreements are twofold. The first is to assure more guarantees for their direct investments, for instance by ensuring that the problems that US multinational corporations face in other countries are resolved by “independent arbitration” rather than by those countries’ legal systems. The second is to create additional protection for their intellectual property rights.

In both cases, the interests of the multinational corporations predominate. This is something that I can understand if I adopt the point of view of the rich countries. Today they are increasingly less involved in production. They are essentially knowledge countries and rentier countries. They receive a substantial portion of their revenues in the form of remittances of profits and royalties from the multinational corporations, while, naturally, always arguing that this is a win-win game in which the interests of the developing countries are also duly considered.

The original criticism

Developmental politicians and intellectuals framed the original criticism of the policy of growth cum foreign indebtedness mainly in the 1950s and 1960s. They focused on the law of comparative foreign advantage and on the remittance of profit. The criticism of the Ricardians – the Prebisch–Singer Law – was strong enough to legitimize the decision of many developing countries to build a tariff system protecting their infant industries. But the Rest *failed* to frame a persuasive argument against foreign loans. Developing countries didn’t know how to reject logically the comparison between the indebtedness in foreign money of a country and the foreign indebtedness of a firm; they were unable to demonstrate that a loan to a business enterprise in the country’s money is very different from a loan to this same enterprise in foreign currency. As to direct investment, it became a problem only in the 1950s, when the manufacturing corporations in the West responded to the developing countries’ protection of their domestic markets by undertaking foreign direct investment. Again, the Rest didn’t have a theory on which to base the framework of conditionalities to these

investments. The developing countries' critique was either outdated or insufficient. It was outdated when they argued that the multinational corporations invested only in mining and in monopolist public services – something that was not true from the 1950s. It was insufficient when they founded their critique on the remittance of profits. But why be concerned about profits if the foreign corporation had made additional investment that increased the productive capacity of the country?

It was an objective fact that, originally, the more successful countries, namely the East Asian countries including Japan, didn't open their markets to foreign investment. In the 1970s developmental economists and politicians used this fact to justify the adoption of developmental policies, while the United States, which was facing a domestic economic crisis and experiencing military defeat in Vietnam, was on the defensive. But soon the picture was reversed, as the foreign debt crisis of the 1980s weakened developing countries, strengthened rich ones, and enabled the latter to impose neoliberal reforms on highly indebted countries by means of the 1985 Baker Plan,⁴ which requested the World Bank to carry out "market-oriented reforms" and the IMF to implement "structural adjustment". Both policies were understood to be necessary: market reforms "because the import substitution model had failed", and structural adjustment because, indeed, many countries were bankrupted and were facing high inflation. Actually, the import-substitution model of industrialization had been exhausted long before, in the late 1950s, and the two more successful Latin American countries – Brazil and Mexico – were engaged in an efficacious strategy of exporting manufactured goods. For instance, Brazil's exports of manufactured goods, which represented only 6% of total exports in 1965, jumped to 62% in 1990. What had interrupted the growth of these countries in 1980 was the foreign debt crisis of the 1980s, the *de facto* moratoriums on debt servicing, and the high inflation associated with this balance of payment crisis.

In the 1980s the six original NICs fell apart; but while the four Asian tigers continued to grow fast, and today, 36 years later, are already rich countries, Brazil and Mexico fell behind. There are, essentially, two reasons for these different outcomes. First, the Asian countries didn't get involved in the growth cum foreign savings policy in the previous decade as the Latin American countries did, and so didn't face a real debt crisis in the 1980s;⁵ and second, the East Asian countries continued to be developmental societies, while Latin America, under the pressure of the Washington Consensus, bowed to the West in the late 1980s. Developmentalism was forgotten, the industrialization project was abandoned, trade and financial liberalization was adopted, and countries got involved in large privatization programs that included even monopolistic public services. As well, growth rates fell as economies suffered a process of re-primarization, perversely transferring labor from manufacturing industry to low per-capita-income services, from sophisticated and well-paid activities to less sophisticated and poorly paid ones. Mexico, instead of experiencing re-primarization, experienced "maquilization" – the transformation of most of its manufacturing industry (not only the maquilas in the frontier with the United States) into plants that assemble imported inputs using cheap labor – industries also producing low per-capita added value.

At that time developmental ideas were a shambles. Classical developmentalism or Latin American structuralism had little to offer. The “associated dependency” theory, which became dominant in Latin America in the 1970s, made the first attack, as it dismissed the possibility of a national bourgeoisie emerging to lead the industrial revolution in developing countries, as had happened in the rich countries, and defended the association with (subordination to) the West. The crisis of Keynesian macroeconomics in the 1970s, and the simultaneous rise of monetarist and neoclassical economics, represented a second major blow. In the early 1980s Albert Hirschman (1981) wrote the epitaph of development economics in a paper whose title is self-explanatory: “The rise and decline of development economics.” Thus, when the foreign debt crisis broke in the 1980s, the West ignored the fact that it was mainly a consequence of the growth cum foreign indebtedness policy adopted in the 1970s; and, profiting from the weakness of the developing countries, it was able to persuade their elites, other than the fast-growing Asian countries, that the cause of the crisis was the exhaustion of the import-substitution model of industrialization, which would be inescapably a victim of fiscal populism. Actually, there was a problem of fiscal populism in the countries in crisis, but the direct cause of the crisis was not fiscal populism but exchange-rate populism – the practice of the nation-state (not only the public sector but also the private sector) getting involved in current-account deficits – which the West does not criticize but *encourages*.

From the mid-1980s developing countries, other than the fast-growing Asian countries, lost the capacity to resist neoliberalism and neoclassical theory, and so ceased to be able to argue against the growth cum foreign savings policy – a policy that the West assumed to be virtuous by definition. The same happened to other Washington Consensus reforms, such as financial liberalization and the privatization of public service monopolies, two reforms that were in the interests of the West, not of the Rest.

It was in such framework that Ha-Joon Chang (2002) and Erik Reinert (2007) published their books renewing criticism of the West. They argue and demonstrate that, since the 1980s, the Washington Consensus had been attempting to inhibit the adoption by developing countries of the very same policies and institutions that rich countries had embraced in the 18th and 19th centuries, when they were undergoing their national and industrial revolutions. These two remarkable books showed forcefully how the West was limiting the policy space of developing countries, but their criticism didn’t include the growth cum foreign savings policy. At the same, and mainly after the 2008 Global Financial Crisis, the economists associated to the only international institution that deals appropriately with the problems of developing countries, centered its focus in the critique of financialization – or “finance-driven globalization”.⁶ The criticism is correct; it is a criticism of practices associated with leveraged speculation and fraudulent financial innovations that became dominant in financial markets and caused harm to rich as well as to developing countries. But it should not be confused with the criticism of the growth *cum* foreign indebtedness policy that I is key to new developmentalism.

New Developmentalism's criticism

In the 1990s many developing countries – now under neoliberal domination – were able to carry out fiscal adjustment and control inflation; but, predictably, they were unable to reduce economic inequalities and resume growth. This opened the way for the gradual formulation of a new theoretical framework, based on classical developmentalism and post-Keynesian macroeconomics, which came to be called New Developmentalism – a work in progress that is oriented to middle-income countries. This theoretical framework already embraces a microeconomics, a macroeconomics, and a political economy. The microeconomics is built on classical developmentalism's association of growth with structural change and productive sophistication; developmental macroeconomics is based on the tendency to the cyclical and chronic overvaluation of the exchange rate and on the problem of access to demand, and is focused on the exchange rate and on the current account deficit; and the political economy deals with the historical concept of the developmental state and the concept of developmental class coalitions associating business industrialists with the popular classes and the public bureaucracy.⁷

One of the key claims of the new theoretical approach is that developing countries don't need foreign capital in order to grow and catch up, except in certain special circumstances. The growth cum foreign savings policy is a hindrance rather than a help to developing countries, except in moments when a country is already growing fast, the marginal propensity to consume falls, and the rate of substitution of foreign for domestic savings falls. Except in these circumstances, the orthodox claim – that current-account deficits (foreign savings) will increase the investment and the growth rates provided that it is financed by direct investment or by loans directly associated with capital accumulation – is false. On the contrary, current-account deficits are in most cases harmful to growth. For sure, they wouldn't be harmful if they were caused by, effectively, additional investment; but usually, even when they assume the form of foreign direct investment, they end up financing more consumption than investment.

On that matter, new developmentalism shows theoretically two things related to the exchange rate and the current-account balance that reinforce each other: first, if a country has the Dutch disease, it should have a current-account surplus in order to grow; second, even if this is not the case, the country should not adopt the growth cum foreign savings policy because such a policy involves a high rate of substitution of foreign for domestic savings.

I offer two arguments in this direction, both associated with the exchange rate. Both proceed from a core claim of developmental macroeconomics, namely that growth depends on investment, which depends on the interest rate and on the expected rate of profit, which in turn depends on effective demand and *access* to demand, which a currency that is overvalued *over the long-term* does not assure. The assumption is that long-term overvaluation is the rule rather than the exception in developing countries, in which a competent exchange-rate policy does not neutralize the tendency to the cyclical and chronic overvaluation of the exchange rate. The fact that the overvaluation persists over the long term – that

it is not just a misalignment – is essential for the argument because, in this circumstance, the businessman who is deciding whether or not to invest will take into consideration this overvalued currency and will not invest. By contrast, when the exchange rate is experiencing a short-term misalignment, the businessman interested in the long term will consider the average exchange rate, which will not be overvalued, and may invest.

There are two causes for such a tendency, which correspond to the two arguments cited above. One cause is the policies that developing countries routinely adopt, and that overvalue the national currency; the other is the Dutch disease, which most developing countries face, but which today few, if any, neutralize.

I will begin with the Dutch disease. It is not a cause of current account deficits, because it is consistent with the *current equilibrium* – the value or level of the exchange rate which balances inter-temporally the country's current account. But a country that has a permanent Dutch disease *must* have a current-account surplus in order to have the exchange rate floating around the competitive or *industrial equilibrium*; if the disease is less severe and appears only during commodity booms, the country will have to run a current-account surplus at these moments.

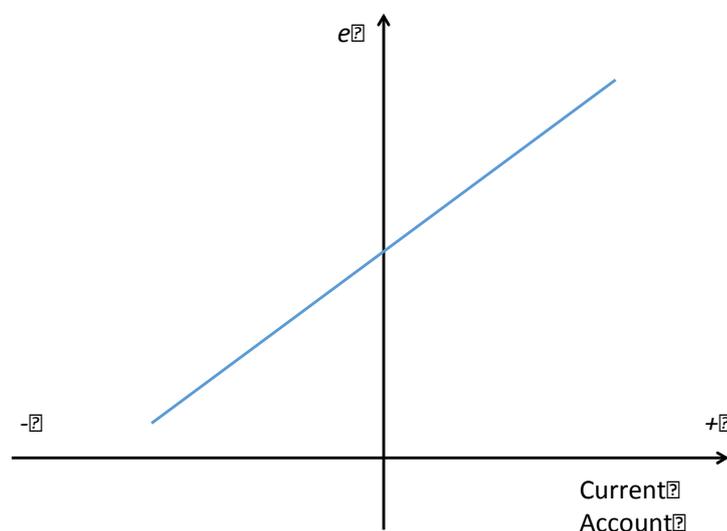
The Dutch disease is a long-term appreciation of the exchange rate caused by Ricardian rents that arise from the exploitation of natural resources and/or by commodity booms which involve a long-term overvaluation of the exchange rate, because the exchange rate that makes such commodities competitive and defines the current equilibrium exchange rate is substantially more appreciated than the industrial equilibrium, which makes competitive the non-commodity tradable goods and services that utilize world state-of-the-art technology. The severity of the Dutch disease, or natural-resource curse,⁸ is measured by the difference between the two equilibriums. Neutralizing the Dutch disease means shifting the value of the exchange rate around which it floats from the current equilibrium to the industrial equilibrium – which will represent a current-account surplus and the corresponding competitive market exchange rate. Thus, this amounts to a very strong argument against foreign savings or current-account deficits.

Let us turn now to the second argument, related directly to the growth cum foreign savings policy. Developing countries usually don't run current-account balances corresponding to the current equilibrium, much less consistent with the industrial equilibrium – they run deficits. Deficits which, as I have already demonstrated, are, essentially, *desired* deficits, in so far as their causes are *three usual policies* adopted by developing countries: the growth cum foreign indebtedness policy, a monetary policy defining a high level of interest rate around which the central bank manages the market interest rate, and the use of the exchange rate anchor to control inflation.

Well, if we assume that the usual thing – and certainly what the West expects from the Rest countries – is current-account deficits, why do not such deficits contribute to economic development even when they are financed by direct

investment? Or, in other words, why do not foreign savings add to domestic savings as nicely as most expect?

Figure 3: Relation between the current account and the exchange rate



The theory is very simple. The current-account deficit or surplus, independently of how it is financed, *corresponds* to a more appreciated currency, as we see in Figure 3. Given this relation, the theory has two explanations why the rate of substitution of foreign for domestic savings increases with the current-account deficit. Both proceed from that correspondence between current-account balances and the exchange rate, and from the appreciation of the national currency due to the increase in the current-account deficit. On the *demand* side, the model says that, if we are already in the realm of deficit, the corresponding appreciated currency disconnects the competent firms of the country from existing domestic and foreign demand, and so discourages investment, and correspondingly reduces domestic savings; if we increase the current account deficit, the exchange rate will appreciate further, the disconnection will be stronger, and more and more firms will lose their market to other countries' firms. On the *revenue* side, the more appreciated the currency is, the greater will be the buying power of consumers or their disposable income. In consequence, they will spend more than a competitive exchange rate would allow, and the domestic savings of the country are reduced, with foreign savings substituting for domestic savings. In both cases, there is an implicit rate of substitution of foreign savings for domestic savings, which, as I argued in Bresser and Gala (2008), depends mainly on the marginal propensity to consume.

Is this rate of substitution always high? Since this is a historical model, not a hypothetical-deductive syllogism, the answer is "not always but most of the time". The marginal propensity to consume is generally high in developing countries. But, when a country is growing very fast, because investment opportunities are high and firms are investing strongly, investment perspectives

attract consumers who reduce their marginal propensity to consume and invest, and, in consequence, the rate of substitution of foreign savings for domestic savings falls.

And what of the analogy between countries and firms – the claim that foreign finance will be benign provided that the return on the investment is higher than the interest rate paid on the loan? But a country is very different from a business enterprise. In the case of the country, there is the effect of the capital inflow on the exchange rate – a problem that does not exist for the business enterprise that incurs debts in foreign money. The problem lies not in the exchange-rate risk, which the firm incurs, but in the fact that the capital inflows appreciate the exchange rate and discourage investment.

Another question: in the case of direct investment, how can it be diverted to consumption, since the capital inflow is deemed to finance real additional investment? First, not all the inflows that countries classify as foreign direct investment do really finance additional investment. But, even if they did, the additional investment may not materialize, because capital inflows are fungible. It is impossible to know what, eventually, will be done with the extra capital inflows. They may directly finance investment, but, as a trade-off, investments will be discouraged, or consumers' disposable revenues increased, or both; and the final outcome may well be a partial or even a total (100%) rate of substitution of foreign savings for domestic savings.

East Asian compared with Latin American and African countries

The conclusion that developing countries don't need foreign finance, that it is usually detrimental to their economic growth, may seem surprising to Latin Americans and Africans; but if we look to the fast-growing Asian countries, such as South Korea, Vietnam and China, we will see that they usually run current-account surpluses, and are even free from the Dutch disease. The Latin American and the African countries, which are cursed⁹ with abundant and cheap natural resources, should run large current-account surpluses, because they have two arguments in this direction – the Dutch disease argument and the rate of substitution of foreign savings for domestic savings argument – while the fast-growing Asian countries have only the second. That is one (not the only) basic reason why they grow faster; that is why they seldom get caught up in balance of payment crises, which are frequent in Latin American and African countries. They seldom get involved in high current-account deficits. In the 1990s, at a time when the American and neoliberal hegemony were unchallenged, four of them did get involved in current-account deficits, and together faced a major currency crisis. But they learned the lesson, and since then they have run large current-account surpluses and built up reserves.

The fact that a country does not need foreign finance *does not* mean that it should accept no investment from multinational companies. But such companies have lost the argument that their representatives cite to legitimize their occupation of the domestic markets of developing countries. They are welcome if they transfer technology, or if they export, or if their investments are

compensated by foreign investments of the receiving country, as it happens among rich countries. What is essential is that the receiving country has a current-account balance or surplus: a current-account balance if the country does not have the Dutch disease, a current-account surplus if it does have the disease – and the more severe the disease is, the larger the surplus should be. As a result, the country's exchange rate will not be over-appreciated but competitive; the domestic firms will not face a competitive disadvantage, but will compete on equal terms with firms of other countries.

Once this condition has been met, the country will be able to receive direct investment, legitimized not by “the lack of capital” but rather by the commitment of multinational corporations to technology transfers or to exports – something that China, for one, requires from foreign investors. Clearly, the great bulk of direct investment in developing countries fails to meet these two conditions and, therefore, it is simply a means for rich countries to impose seigniorage on their domestic markets.

The political economy involved

In summary, developing countries will grow faster if they run a current-account balance or surplus, because this is the way to neutralize the tendency to the cyclical and chronic overvaluation of the exchange rate and to maintain a competitive exchange rate. Thus, they don't need foreign finance. When they accept it, their economies are usually harmed, not improved. The question, therefore, is: why don't developing countries realize this and eliminate their current-account deficits?

The answer is relatively simple. The deficits are in the interest of the West and in the short-term interest of politicians and consumers in developing countries. The interest of rich countries is obvious. They benefit from exporting to developing countries more than they import from them; more important, they gain from legitimizing their loans and the occupation of developing countries' domestic markets by their multinational corporations without real reciprocity.

As for the short-term interest of politicians and consumers in developing countries, this derives from the simple fact that an overvalued currency (a currency below the industrial equilibrium) means lower inflation (while the depreciation is taking place) and higher revenues for workers and the technobureaucratic middle class (wages and salaries) and for capitalist rentiers, in the form of the interest, dividends and real-estate rents that they receive. Thus, this is very attractive to populist politicians, who know that their societies have a strong preference for immediate consumption. But there is a second reason for the incapacity that the elites of developing countries often display in defending the national interest of their people: their weak idea of nation, and their ideological subordination to the economic theories and ideologies of the West, which they view as embodying the truth, and nothing but the truth.

In the political economy of current-account deficits and foreign direct investment, the West uses all possible ideological weapons. Here I will comment on just one. The United Nations in Geneva has a division devoted to the study of foreign direct investment.¹⁰ Every year this division distributes a press release listing the names of the ten countries that have received the most direct investment in the previous year. Rich countries – particularly the United States, Germany, Britain and France – usually come top in this small table; Brazil was usually around the eighth place of the list up to the 1990s; in the last twenty years, China has risen to the top of the list or near it. What ideological message does this innocent table convey, which only China in some way upsets? That foreign direct investment is a “wonderful thing” – so wonderful that rich countries receive it with gusto. But this message is highly misleading. What is really important are the *net* figures: capital outflows versus capital inflows. These should give rise to two small tables: one with the ten most positive outflows, which will show the countries that made most direct investment without reciprocation, and the other with the most negative outflows, which will show the countries that received most direct investment without reciprocation. In the first table, we will see the major rich countries, and in the second the major developing countries. And the UN division would leave the interpretation to each reader of its press release. But, on the contrary, it suggests that all countries should welcome foreign direct investments because the richer countries welcome them.

One interesting thing about this political economy of current-account deficits is how the imperial interests of the West coincide with, in developing countries, the loss of the idea of nation of the dependent local elites and the high preference for immediate consumption of the people, to produce a perverse policy and a bad outcome.

Conclusion

In conclusion, the West’s domination and the developmental response to such domination have undergone changes over the course of history. Imperialism appeared in 19th century as a consequence of the increased power of the countries that first made the industrial revolution – the United Kingdom, Belgium and France – relative to the peoples of Africa and Asia, which, when the Americas were colonized, were powerful enough to resist European colonialism. This imperialism led the colonized peoples – the Chinese and Indians in particular – to massive economic decline. Meanwhile, Latin-American countries freed themselves in the early 19th century from Spain and Portugal, and their decadent mercantilist metropolis developed, but slowly because their elites were culturally and economically dependent on the imperial center.

After World War II, all European colonies achieved independence and imperialism ceased to be explicit. The hegemony or the soft power that the West was already exerting in Latin America spread to the rest of the world. The imperialist rationale – occupation of developing countries’ domestic markets – was now implemented by co-opting the peripheral elites, by persuading them of

the benefits of trade liberalization and the growth cum foreign savings policy. Initially the West failed in this project, even in the Latin American countries, because national elites adopted developmental policies. After World War II, classical developmentalism was able to criticize the inequality involved in trade liberalization, but was not able to criticize growth with foreign finance. In the decade following the West's strong hegemony in the 1990s, new developmentalism was able to criticize the foreign savings policy, showing that developing countries don't need foreign finance and that it is usually harmful to their development since loans as well as foreign direct investment finance consumption rather than investment, while increasing the financial or the patrimonial foreign debt of the country.

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¹ This was the case with Brazil, which industrialized between 1930 and 1980, and became an exporter of manufactured goods. The neutralization of the Dutch disease was achieved by adopting either a system of multiple exchange rates or a system of high tariffs on imported manufactured goods combined with high subsidies for exporters of such goods. This neutralization mechanism was dismantled when the country liberalized trade in 1990. Since then Brazil has been de-industrializing and growing much more slowly than in the period of industrialization.

² See Bresser-Pereira (2015) and Bresser-Pereira and Ianoni (2015).

³ See Fry (1978), Schmidt-Hebbel et al. (1992), Edwards (1995), Reinhart and Talvi (1998), Uthoff and Titelman (1998).

⁴ This 1985 plan, formulated to solve the 1980s' Foreign Debt Crisis, was called the Baker Plan after James Baker, then the U.S. Secretary of the Treasury, who gave to the World Bank the responsibility for the "market oriented reforms", which would complement the "structural adjustments" that were already being undertaken by the International Monetary Fund.

⁵ Some Asian countries – specifically, South Korea, Thailand, Indonesia and Malaysia – would suffer a currency crisis in 1996, which, as had happened to Latin America, was also a consequence of the growth cum foreign savings policy.

⁶ Alfredo Calcagno (2015).

⁷ On this developmental macroeconomics see Bresser-Pereira (2010) and Bresser-Pereira, Marconi and Oreiro (2014).

⁸ There is a line of thought that distinguishes the Dutch disease, which would be a not very well-defined economic problem, from the natural resource curse, which would be a political or moral problem associated with the rent-seeking involved in the exploitation of natural resources. I don't deny that there are two problems, but I use the two expressions 'Dutch disease' and 'natural resource curse' interchangeably to refer to the coincidence of the two problems that is usually stronger the poorer and less institutionalized a country is. In this way I avoid the problem of paying attention just to the political-moral problem while leaving aside the economic problem which is fundamental.

⁹ Cursed either because the policymakers believe in reasonably efficient markets, or because they don't neutralize the Dutch disease because they don't know how to.

¹⁰ I refer to the FDI Statistics Division on Investment and Enterprise of UNCTAD, United Nations. However, being part of UNCTAD, this division adopts an approach that has

no relation to the developmental approach that the yearly *Trade and Development Report* has been adopting for years, with strong restrictions imposed by the West.