The political economy of emergent countries

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The political economy of the Washington consensus is very simple

- Economists led by the IMF and World Bank ask developing countries to adopt a bundle of liberal macroeconomic policies and microeconomic reforms.
- The key demand is for fiscal responsibility.
- Political scientists assume that these were the right thing to do, and posed a political economy question:
- "Which are the political obstacles for such policies and reforms?"
- And concluded: "the main obstacle is the fiscal populism" of local politicians.

The developmental response to the liberal demands was also simple

- The importance given to the control of inflation is excessive; the fundamental objectives are growth and distribution.
- Liberal economists offer austerity solutions that are prociclical non-solution.
- The key problem is not lack of fiscal responsibility, but lack of industrial policy.
- The political economy problem is to identify the interests behind austerity

I will not go back to this debate because it is old and both sides are wrong

- Liberal economists and political scientists are wrong when they pay excessive attention to inflation, and when they favor chronic austerity, high interest rates and an overvalued currency, because both attract foreign savings (foreign indebtedness).
- They are right when they are concerned with fiscal irresponsibility.
- Classical developmentalists are wrong when they pay little attention to macroeconomic equilibrium, and when they favor chronic expansionist fiscal policies and high wages, and when they overestimate the power of fiscal policy.
- They are right when they say say that fiscal adjustment is not the cure for all evils.

Instead I will

- Offer the new-developmental approach on the two economic responsibilities:

1. Fiscal responsibility (which everybody knows)
2. Exchange rate or foreign debt responsibility (which is largely ignored)

- Argue that both are required, but the later is more important than the former.
- Ask for the interests or the political economy behind exchange rate irresponsibility.

The two economic policicy irresponsibilities

- Fiscal irresponsibility

-the state to expend more than it gets chronically, thus increasing the public debt-GDP ratio.

- Exchange rate irresponsibility

-the nation-state to expend more than it gets, incurring in chronic current account deficits, which increase the financial and the patrimonial (direct investments) foreign debt.

Fiscal responsibility

- The state adopts an expansive fiscal policy only contra-cyclically;
- once the economy achieves the “normal condition” (not necessarily full employment), the state should reduce the public debt to keep it confortable.
- The objective is to have a capable and strong state, which

1. is able to finance public investments (20%) with public savings,
2. and owns public banks able to finance business enterprises’ investments (80%).

Exchange rate responsiblity

The government adopts a set of policies which keep the current account either

1. balanced, or
2. with surplus (if Dutch disease is serious).

so that the exchange rate floats around the industrial equilibrium, which guarantees that the business enterprises adopting technology in the world state-of-the-art are competitive.

No current account deficit: emerging countries don't need foreign capitals.

A current account deficit involves the appreciation of the national currency, which reduces the expected rate of profit, and involves a high rate of substitution of foreign for domstic savings, so that, instead o investment, the "foreign savings" (the deficit) finances consumption.

Exchange rate policy

- Besides the text-book policies (interest rate policy, fiscal policy, purchase or sell of reserves, capital controls).
- To reject two usual policies:

1. growth *cum* current account deficits (foreign indebtedness), and
2. exchange rate anchor to control inflation.

- To neutralize the Dutch disease with a export tax on the commodities that originate it.
- To adopt high tariffs is a second best policy for neutralizing the Dutch disease is a second best policy, which only neutralizes it in the domestic market, and is often viewed as protectionism.

The political economy behind fiscal irresponsibility

- It is well known.
- It has the support of vulgar Keynesians, who have a very lax concept of recession or a very narrow definition of full employment, and preach chronic and high budget deficits.

- It is on the interest of populist politicians.

The political economy behind exchange rate irresponsability

- It is very poorly know.
- Orthdox economists as well as vulgar Keynesians don’t acknowledge it.

- It is on the interest of populist politicians and of vulgar Keynesian as well as orthdodox (liberal) economists who represent the interests of rentier capitalists and financiers and foreign countries, their financial system and their multinational enterprises.

Why rentier capitalists, financiers and foreign countries?

- Rentiers and financiers, because their priority is a real interest rate, which depends on a high nominal rate (which attracts capitals and appreciates the currency) and a low inflation (which can be achived by using the exchange rate as an anchor against inflation.
- Foreign countries, because the more appreciated the currency, the greater will be their exports
- International finance and multinationals, because the more "legitimate" will be their not need capitals in the form of foreign financing and direct investments.
- What emerging countries need is knowledge, not capitals.

END

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