The New Developmentalism

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The idea of a "new developmentalism" appeared in Brazil in the beginning of the 2000s as an alternative both to the neoliberal orthodoxy, which had prevailed throughout the world for almost thirty years, and to old developmentalism, which characterized many developing countries after the Second World War. Developmentalism was underpinned by the structuralist development theory – a system of ideas which the structuralist development economists or the development pioneers elaborated on the basis of the canonical works of Raul Prebisch (1949), Ragnar Nurkse (1953) and Arthur Lewis (1954), and which was applied to countries that were on the threshold of their industrial and capitalist revolutions. Fifty years later, in the context of globalization, a quite different economic and political world, the developing countries had industrialized and become middle-income and democratic. They needed, therefore, a new critique of the conventional economic theory, new economic models and new policy proposals for economic reform and for social reform, aiming not only at economic development but also at social inclusion. The new developmentalism which began to emerge in Latin America in the 2000s was a response both to these demands and to the failure of the Washington Consensus and, more broadly, of the 30 Neoliberal Years of Capitalism (1979–2008).

In 2003 I introduced the concept of the new developmentalism, placing it in opposition both to the Washington Consensus and to the old developmentalism.[1] In doing so, I reflected, and endeavored to renew, the critique of the neoliberal orthodoxy framed by a number of first-rate economists. Soon, a large group of Post Keynesian and structuralist economists joined us, and in 2010 eighty of the world's most eminent development macroeconomists and political economists discussed and approved a document titled "Ten Theses on New Developmentalism".[2] Robert Frenkel, Amit Bhaduri, Jan Kregel, Heiner Flassback, Fernando Cardim Carvalho, Gabriel Palma, Robert Boyer were some of the most authoritative voices in this debate. The new developmentalism thus became an alternative strategy to the Washington Consensus and to the old developmentalism, and, with the ten theses, also became an institution, an ensemble of defined and shared diagnoses, ideas and policies. It became what Max Weber called an ideal type – an abstract and systemic description of economic, social and political phenomena.[3] On the other hand, as an increasing number of left-wing politicians and developmentalists were elected in the region, we witnessed once again, after the interregnum of the neoliberal years, the building of a developmental state.

The new developmentalism conceived as an ideal type is not, therefore, simply a list of policies. In addition to being an informal national development strategy, it is

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the underlying institution for economic development; it is a summing up of values, goals, policies, laws and, chiefly, understandings and commitments which engender investment opportunities for entrepreneurs and improve the living standards of the population; it is a form of state – the developmental state; it is the fruit of a developmental class coalition or political pact.

In any society, some kind of consensus on the policies adopted is crucial. When these policies and their underlying ideas are not imposed but, rather, freely adopted by society, we might assume that, despite the problems of representation or agency, there is a social agreement or a developmental political pact. In democracies, the implementation of a new developmentalism entails the government's relying on the support of the people and part of the elite – an ample support base bringing together the social classes.

The new developmentalism does not exist anywhere in a pure form. The governments of developing countries often embrace ineffective and unreliable policies, regardless of whether they reflect the ideas of old-developmental, neoliberal orthodox, or new-developmental economists. But when there is a developmental social agreement, and a nation espouses a developmental strategy that resembles the one outlined above, we might say that this nation is building a new-developmental state and is actually realizing its development. The existence of a social agreement does not mean the presence of complete consensus. Liberal and dependent elites and external interests – the classical opponents of the developmental state – will persist in opposing its main features, namely the strategic role played by the state in advancing development and reducing inequalities, the priority assigned to development and the emphasis placed on the social and environmental setting. Nor is a social agreement on development within the class coalition necessarily permanent. Support for development has to be constantly rebuilt, since it is always vulnerable to being eroded or destroyed. When this happens, the way is open for class struggle, liberal domination and social repression.

The new developmental state is a form of state adapted to global capitalism, that is, to a stage of capitalism where economic competition among nations is of the essence. The role of the state is to create investment opportunities, to invest when necessary, and to regulate the market, the financial market in particular, in order to ensure growth with price stability and financial stability. I understand development to signify not only as increasing economic growth and industrialization, but also a reduction in social inequalities and an improvement in the living standards of the population.

In this paper I will summarize these new ideas, contrasting them both to the old developmentalism and to the neoliberal orthodoxy. Instead of distinguishing between policies (the new developmentalism) and theory (structuralist development macroeconomics), I will bring economic policies and theory under the name of "new developmentalism". I do thereby mean to say that the distinction between policies and theory is not useful. It seems to me, however, that insofar as we think of the new developmentalism not only as a national development strategy but also as a historical ideal type, merging the theoretical and the policy aspects is fruitful.

The old developmentalism, the neoliberal orthodoxy, and the new developmentalism

Scope

The old developmentalism was applied to countries that were beginning their industrial revolution; the neoliberal orthodoxy aims to be applicable to all kinds of countries; the new developmentalism applies to middle-income countries that have already concluded their capitalist revolution.

The state in production

The old developmentalism ascribed to the state an important role in production; the neoliberal orthodoxy, none; the new developmentalism limits an active role of the state to the monopolistic or near-monopolistic sectors, in particular to infrastructure sectors, mining and public services; around 20 percent of total investment should be undertaken by the state.

Strategic role of the state

Both the old developmentalism and the new developmentalism assign a strategic role to the state in defining and implementing, jointly with society, a national developmental strategy; the neoliberal orthodoxy limits the role of the state to ensuring property rights, contracts and antitrust enforcement.

Planning

The old developmentalism ascribed a fundamental role to economic planning; the neoliberal orthodoxy rejects it; the new developmentalism divides the economy into a competitive and a monopolistic sector (that comprise infrastructure, public services, base industry and large-scale mining); while for the later planning is required, for the former coordination alone does the job satisfactorily.

Fiscal accountability

Both the new and the old developmentalism and the neoliberal orthodoxy recommend resort to limited budget deficits in times of crisis; all three, therefore, espouse fiscal accountability. But while developmentalists are always menaced by vulgar Keynesianism, which recommends increase of public spending in response to almost every difficulty, the neoliberal orthodoxy is menaced by an equally vulgar predisposition to treat reductions in public spending as a kind of panacea.

Interest rate and exchange rate

The old developmentalism paid little attention to the interest rate, the exchange rate, or the formulation of macroeconomic policies, and emphasized industrial policy (whose the scope was broad enough to include macroeconomic issues such as the effective exchange rate determined by import tariffs and export subsidies); the neoliberal orthodoxy pays no attention to either the interest rate or the exchange rate, because it assumes that these macroeconomic prices are correctly determined by the market. The new developmentalism rejects this assumption and affirms that in developing countries the interest rate tends to be excessively high because it is abused as an instrument to control inflation and because policymaker justify their policy asserting that it is a cure to "financial repression" that would exist in developing countries. As to the exchange rate, which plays a central role in structuralist development macroeconomics, new developmentalism affirms that the exchange rate tends to be cyclically and chronically overvalued due to the Dutch disease and to the excessive capital inflow caused by high interest rates, by the policy of relying on foreign savings to generate growth, by the use of the exchange rate as an anchor, and by exchange rate populism (that is, the practice adopted by many vote-seeking politicians of fixing the exchange rate, which in the short run reduces inflation and artificially increases wages).

Dutch disease

The old developmentalism recognized the significance of the Dutch disease and attempted to offset it by means of multiple exchange rate regimes or the combination of import tariffs and export subsidies; the neoliberal orthodoxy ignores it; the new developmentalism clearly defines the Dutch disease, regarding it as a permanent overvaluation of the exchange rate caused by Ricardian rents which allow the export of commodities at a substantially higher exchange rate than the rate which other tradable industries need if they are to be competitive.

Domestic market-led or export-led development

Development is domestic market-led when import-substitution industrialization prevails, the import-export coefficient is falling, and, if this fall is the outcome of the appreciation of the exchange rate, wages will increase more than profits; it is export-led when the import-export coefficient is increasing, and, if this rise is consequence of depreciation of the exchange rate, profits will increase more than wages; it is balanced when GDP, exports, wages and profits increase approximately at the same rate. The old developmentalism did not believe that developing countries were likely to export manufactured goods, and advocated import substitution which did not cause wages to increase more than profits except in the short periods of exchange rate appreciation;[4] the neoliberal orthodoxy ignores this discussion and asserts that the law of comparative advantage in international trade will determine the growth model; the new developmentalism assumes that the import-substitution strategy expired long ago for middle-income countries, that the imports coefficient should be reasonably steady and, therefore, if the growth rate is considered satisfactory, development should not be either domestic market-led or export-led, but, rather, balanced; the strategy should be temporarily export-led only if this is necessary to correct the exchange rate in order to increase the investment rate and achieve a desired higher growth rate. In a state of equilibrium in which the exchange rate is in the industrial equilibrium and the investment rate and the growth rate are regarded as satisfactory, wages, profits, exports, GDP and GDP per capita will grow in an approximately equivalent rate, and the rate of profit will be constant also at a satisfactory level, while wages increased with productivity; growth will be balanced. But often the exchange rate is overappreciated, and it will be necessary to depreciate it. In this case, exports and profits will grow more rapidly than wages for a while, but soon the exchange rate will reach the industrial equilibrium, depreciation will stop, and wages will again increase with productivity, while the rate of profit turns again satisfactory, but now wages as well as GDP per capita will increase faster than before the depreciation and the exchange rate was chronically overappreciated.

Competitive exchange rate

The old developmentalism did not pay attention to the need of a competitive exchange rate because it was oriented to the domestic market and to the growth of manufacturing industries, which were protected from international competition; the neoliberal orthodoxy assumes that the exchange rate determined by the market is normally competitive; the new developmentalism asserts that the market, if working properly, tends to lead the exchange rate to "current-account equilibrium" (that which intertemporarily balances the country's current account), but where the Dutch disease has taken hold (what is the case of most developing countries, including the fast growing Asian countries, the actual equilibrium exchange rate, the effectively competitive rate, is the "industrial equilibrium exchange rate", that is, the exchange rate that allows tradable industries to be competitive utilizing state-of-the-art technology.

Inflation

The old developmentalism embraced the theory of structural inflation based on supply bottlenecks, and accepted inflation of up to 20 percent a year; the neoliberal orthodoxy does not see any grounds for developing countries to run inflation rates that exceed international standards; the new developmentalism concurs with the neoliberal orthodoxy in the case of countries that are already middle-income, since in this circumstance the supply bottlenecks are no longer relevant, but distinguishes accelerating from maintaining and sanctioning factors, and stresses that when inflation has an inertial component contraction of demand is ineffective in controlling it.

Protection or industrial equilibrium exchange rate?

The old developmentalism advocated high customs duties and also multiple exchange rates in order to protect an infant manufacturing industry; neoliberal orthodoxy rejects any kind of protection. The new developmentalism supposes that in middle-income countries industries are no longer infant and sees no grounds for protection, but underlines that import tariffs are often not protectionist but a way of partially neutralizing the Dutch disease;[5] on the other hand, it stresses that import tariffs and the exchange rate are partial substitutes, and requires a competitive exchange rate.

Foreign constraint

The old developmentalism believed in the existence of an external structural restriction to economic growth – namely a permanent scarcity of dollars or other reserve currencies – stemming from an income elasticity of demand for industrial goods greater than one, whereas the income elasticity of primary goods in rich countries is smaller than one, thus justifying relying on foreign savings for growth; the neoliberal orthodoxy strongly supports the thesis because it is interested, on the one hand, in the existence of a chronic current account deficit and therefore a chronically overvalued exchange rate in developing countries, and, on the other, in financing developing countries with loans and direct investment. The new developmentalism rejects the pessimism of old developmentalism in relation to the elasticities problem, and asserts that, first, they have never been so crucial, and, second, that its importance wanes to the extent that a country begins to export manufactured goods. It is true that countries often face a "shortage of dollars", but this shortage is rather consequence of the fact that the exchange rate tends to be chronically overvalued in developing countries, than the consequence of unfavorable elasticities.

Growth with domestic savings

In principle, new developmentalism rejects the growth with foreign savings – the standard recommendation that liberal orthodoxy makes to developing countries. Only in special circumstances, when investment opportunities are high, the country is already growing fast, and the marginal propensity falls, it accepts it. The rejection derives, first, from the fact that there is not an effective foreign constraint; second, that while current account deficits (foreign savings) lead to increased financial fragility and financial currency crisis; third, because the capital inflows caused by the current account deficits appreciate the local currency, and involves generally a high rate of replacement of domestic by foreign saving; forth, because when a country has the Dutch disease, its neutralization (putting the exchange rate in the industrial equilibrium level) implies a current account surplus, not a deficit.

Fixed or floating exchange rate

The old developmentalism accepted the regime of fixed exchange rates enshrined in the Bretton Woods agreement and defended by Keynes; the neoliberal orthodoxy pursues the free float, which is likely to end in financial crisis; the new developmentalism rejects the strict "fix or float" dichotomy and, grounded in the tendency of the exchange rate to cyclical overvaluation, seeks a strongly administered floating exchange rate; and for that it recommends the purchase and sale of reserves, capital controls, and, so as to offset the Dutch disease, a variable tax on exports of the products which generate that disease. Such a tax would be the equivalent of the industrial equilibrium exchange rate minus the current account equilibrium exchange rate, which, by shifting the supply curve in relation to the exchange rate, leads the exchange rate to the industrial equilibrium.

Social development

The old developmentalism was usually part of the development strategy of authoritarian regimes involved in the national and industrial revolutions of their countries; it advocated a better income distribution but did not prescribe any social welfare policy; the neoliberal orthodoxy is concerned only with the free trade because the market will take care of the rest; the new developmentalism is usually implemented in new democracies and should also be a "social" developmentalism – a developmentalism which is also concerned with a more equalitarian distribution of benefits in society.

Two applications

Understood in the terms described in the previous section, the new developmentalism implies a surprising and remarkable policy prescription: developing countries should avoid current account deficits in their search for growth; they should not attempt to grow by relying on foreign savings or foreign financing.

Financing development is of the essence (both Schumpeterian innovation and Keynesian investment are grounded in credit), but credit should be in *national* currency. Foreign finance, in principle, is of no advantage to a country unless it comes with technology or opens opportunities for exports. The great foreign debt crisis of the 1980s revealed that the growth strategy that relied on foreign currency was a great mistake. The mistake was sponsored by the rich countries, eager to become creditors, and achieve either high interest rates or high profit rates from their loans and direct investments by occupying their domestic markets; and it was fostered in developing countries by the misleading thesis of an "foreign structural constraint" to be overcome by resorting to foreign savings. In fact, there is a foreign constraint only if the exchange rate is overvalued – a chronic phenomenon in developing countries. But the harm caused by indebtedness in foreign currency is not limited to the crises it triggers. Actually, it comes about in three stages: first, it appreciates the national currency, artificially increases wages and consumption, and entails a high rate of substitution of internal savings by foreign savings; second, it causes financial fragility, renders the country dependent and drives it to the practice of "confidence building" – of doing everything its creditors demand, which is usually contrary to its national interest; and finally, after the credit bubble has been inflated, and after multinational corporations and banks have earned huge profits from high interest rates, and trader, high bonus, creditors lose confidence, debt rollover is suspended, and a balance of payments financial crisis breaks.

These three stages are part of the classic history of developing countries – always indebted, almost always suffering from low growth rates and always vulnerable to balance of payments crisis. It is the history of the countries that do not seek to offset the tendency of their exchange rates to be cyclically as well as chronically overvalued; and thus, instead of pursuing equilibrium or a current account surplus, they opt for foreign debt. Quite different is the case of the developmental Asian countries that attempt to grow by relying on their own resources, because they are aware that "the capital is made at home".

In most cases, developing countries grow faster if they run current account surpluses and thus help finance the rich countries. The Dutch disease model explains this remarkable truth. For a country to offset the Dutch disease (or the "natural resources curse") it needs to shift its exchange rate from current account equilibrium (which clears its current account) to industrial equilibrium (the exchange rate which allows industries utilizing state-of-the art technology to be competitive). The country should establish an export tax or retention which equals the industrial equilibrium exchange rate minus the current account equilibrium exchange rate, but exporters will bear no cost because they will be rewarded by the exchange depreciation, which is caused by shifting the supply curve in relation to the exchange rate. If it achieves this shift – something that is feasible but not particularly easy – the country will, by definition, have a current account surplus, and the rich countries a current account deficit. At this industrial equilibrium exchange rate, which plays the role of a *light switch*, the efficient enterprises of the country will be connected to international demand, while the possibly less efficient ones in foreign countries that export to this country will be disconnected.

Developing countries, therefore, should not attempt to grow by relying on foreign savings, because a current account deficit indicates exchange overvaluation even when there is no Dutch disease, and even greater overvaluation when there is.

Generally, when a country seeks to grow by relying on foreign savings, that is, with current account deficits, the capital inflow necessary to finance the deficit appreciates the exchange rate and artificially increases real wages since, even when it takes the form of direct investment, it increases consumption more than investment. As a result, besides having to send profits and interest payments abroad, the country ends up facing the threat of a balance of payments crisis.

In the 1990s the neoliberal hegemony was so great that even the developmental Asian countries like South Korea, Thailand, Malaysia and Indonesia forgot that capital is made at home, became externally indebted despite having kept their budgets balanced, and experienced severe balance of payments crises.

The lesson learned by those countries is even more pertinent for countries like Brazil and Argentina, which suffer from the Dutch disease, however moderately. These countries will grow faster if they keep their current accounts in modest surplus.

Conclusion

The economic objective of middle-income countries is to achieve the level of well-being enjoyed by the rich countries; their social goal is to make their societies less unequal. While the liberal-orthodox strategy is rarely compatible with long-term growth, the new-developmental strategy suggests a way to achieve that goal, but it does not guarantee success. The more developed a developing country already is, the more likely it is to succeed, for it already relies on a better-structured society and state. Middle-income countries also face difficulties in being governed, but these challenges are even greater for the poor countries.

A new-developmental state does not need to embrace all the policies presented here – which together can be envisaged as an ideal type – but it has to hold onto a national development strategy supported by a developmental political pact. The government of such a state has a strategic role in investment and in the planning of monopolistic sectors, in macroeconomic policy (especially in relation to the exchange rate), in the regulation of financial markets, and in the social or distributive policies aimed at building up what is not just a developmental state but a social welfare state.

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[1] For a report on the emergence of the new developmentalism and the development structuralist macroeconomics see Bresser-Pereira (2011).

[2] See www.tenthesesonnewdevelopmentalism.org.

[3] According to Max Weber (1917: 90), "an ideal type is formed by the one-sided accentuation of one or more points of view and by the synthesis of a great many diffuse, discrete, more or less present and occasionally absent concrete individual phenomena, which are arranged according to those one-sided emphasized viewpoints into a unified analytical construct..."

[4] According to Bhaduri's and Marglin's wage-led model (1990), that assumed import substitution, inequality would decrease, but, in real terms, in the periods in which prevailed the import substitution model inequality tended to increase, not to decrease.

[5] It is a partial form of neutralizing the Dutch disease because only neutralizes it on the import side, not on the export one.