

New Developmentalism and Keynesian Economics

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Structure of the lecture

I. Overview of New Developmentalism

- Analytical and intellectual influences
- Main propositions
- Getting macroeconomic prices right
- Exchange rate policy

II. Critical Engagement with New Developmentalism

- Keynesian and Neo-Kaleckian critiques

III. Discussion

I. Overview of New Developmentalism

What is New Developmentalism?

- A framework to identify the development challenges of *middle-income countries* and propose a set of macroeconomic and industrial policies to address these challenges.
- Intellectual and historical influences:
 - Classical Developmentalism, Latin American Structuralism, Marx, Keynes, Kalecki, East Asian late industrialisers
 - Common influences with post-Keynesian economics
- Emerged in Brazil in the context of ‘social-developmentalism’ of post-2002 Lula years
- Why the need?
- [Ten theses on New Developmentalism](#)
- From low-income trap to middle-income trap & *premature deindustrialisation*
- Transformation of Development Economics field (Krugman 1994, Rodrik 2008)

Main propositions of New Developmentalism

1. Manufacturing sector is the engine of growth (Kaldor 1967)
2. Investment drives growth & profits drive investment
3. Getting macroeconomics prices right
4. Neutralising Dutch Disease
5. Ending growth with foreign saving
6. Support for an export-led growth model
7. Sound + counter-cyclical monetary and fiscal policy
8. Need for industrial policy
9. Business-bureaucrat-workers political coalition against rentier-financier-foreign interest coalition

Getting prices right

- Five key macroeconomic prices:
 - the exchange rate, the profit rate, the wage rate, the interest rate, the inflation rate
- How do we define 'right'?
- Prices that make sense economically and politically (Bresser-Pereira 2015). A bit vague?
- Focus on the real exchange rate

Getting the Exchange Rate Right

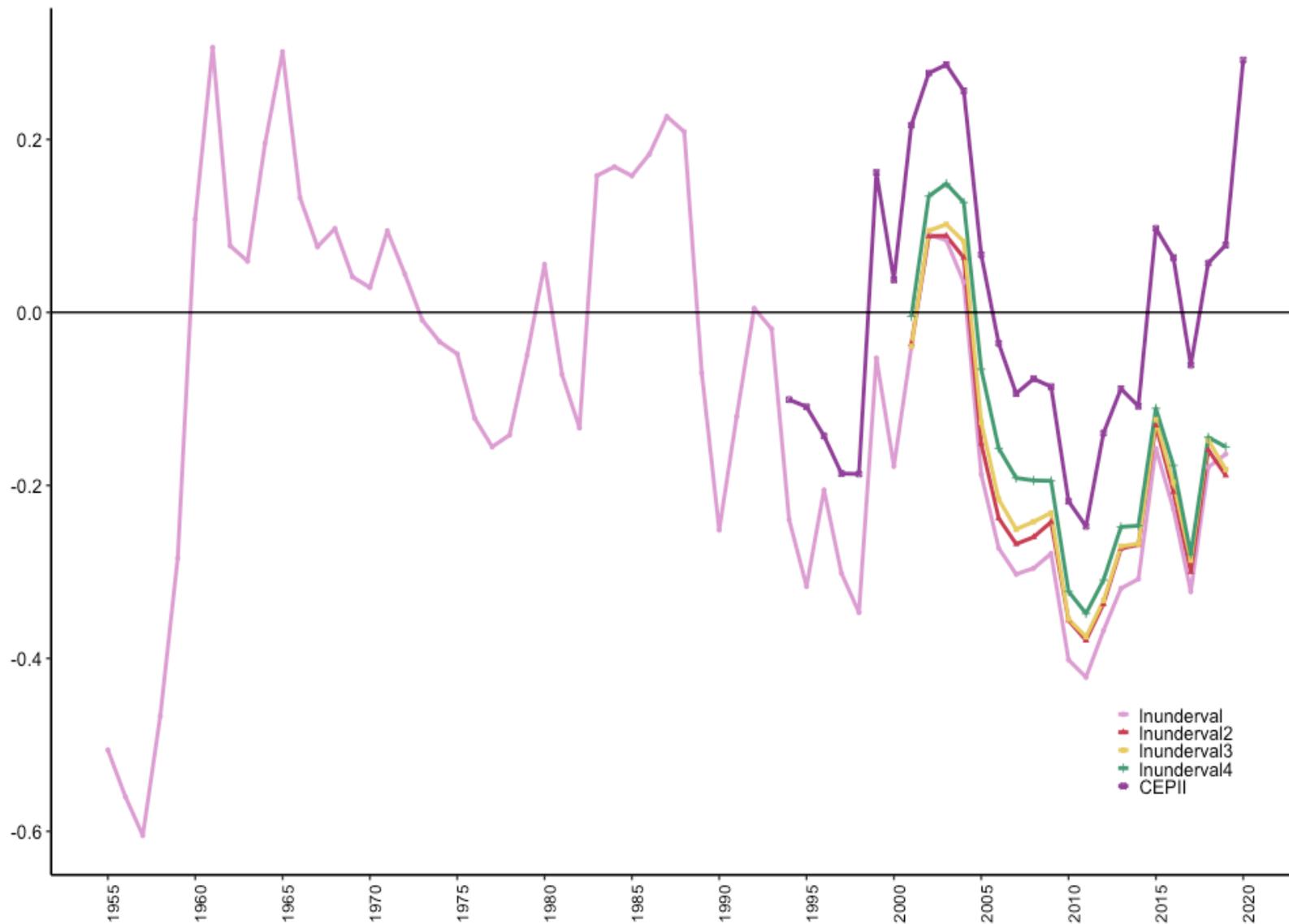
RER is overvalued in many Latin American countries.

Region	1960s	1970s	1980s	1990s	2000s	2010s	1960-2019
East Asia and Pacific	-0.0865	0.149	0.193	0.0586	0.157	0.0924	0.104
Europe and Central Asia	-0.0281	-0.165	-0.108	0.0902	-0.0333	0.0288	-0.0153
Latin America and Caribbean	0.0895	-0.00774	-0.00529	-0.0987	-0.140	-0.198	-0.0712
Middle East and North Africa	-0.172	0.137	-0.0431	-0.0643	0.113	0.179	0.0447
North America	-0.169	-0.209	-0.198	-0.322	-0.376	-0.402	-0.280
South Asia	0.187	0.111	0.294	0.395	0.382	0.378	0.296
Sub-Saharan Africa	0.00626	-0.0716	-0.0615	-0.0705	-0.0137	-0.0397	-0.0424

Source: my calculations using PWT data and Rodrik (2008) methodology

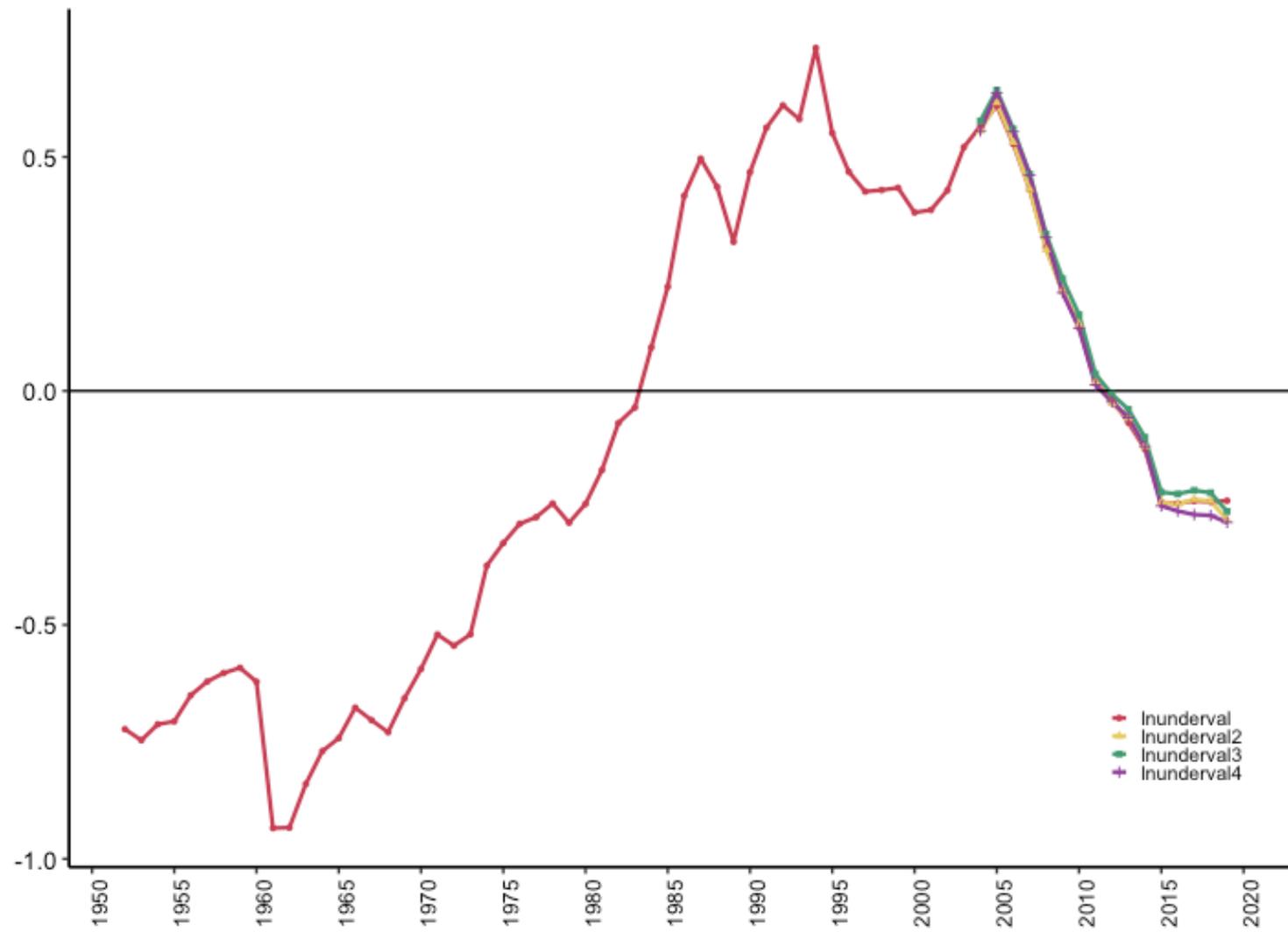
Note: Negative (positive) values indicate overvalued (undervalued) RER

Brazil Misalignment in Brazil



Source: my calculations using data from PWT, WDI, and Lane and Milesi-Ferretti (2001)

China



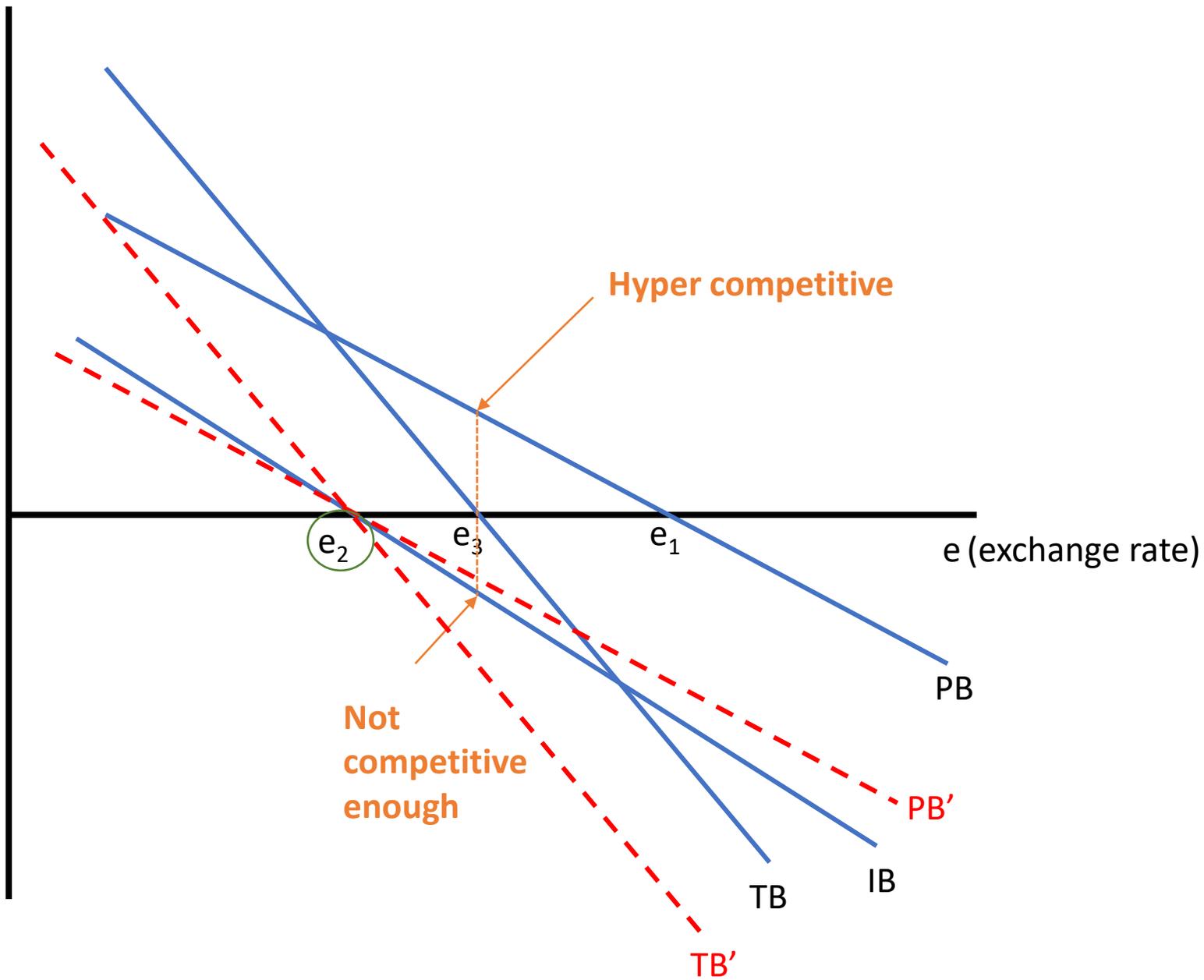
Why these differences matter?

- Large body of theoretical and empirical research on the benefits of undervalued RER
- See Demir and Razmi (2022) for a review article on the subject
- Some findings from this literature:
 - Competitiveness of the tradable sector
 - Shifting resources into the tradable sector (Rodrik 2008)
 - Reaping immediate productivity gains and jumpstarting growth in low income countries (Eichengreen 2007)
 - Diminishing the dependence on foreign capital inflows
 - Reducing unemployment (Frenkel and Ros 2006)
 - Links between investment surges and RER undervaluation (Libman *et al.* 2019)
- Why the policy is at odds with this evidence in Brazil and various other developing countries?

Getting the Exchange Rate Right

- Why the RER is more overvalued in Latin America?
 1. Structural reason
 - The Dutch Disease / resource curse
 2. Policy reasons
 - The growth with current account deficits ('foreign savings') policy
 - High interest rate policy
 - The use of the exchange rate as an anchor to control inflation
 3. Political reasons
 - Exchange rate populism
- The loss of competitiveness of the industrial sector, caused by the overvaluation of the RER, following the discovery of natural resources.

TB, PB, IB



Getting the Exchange Rate Right

1. Structural reason

- The Dutch Disease

2. Policy reasons

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3. Political reasons

- Exchange rate populism

Growth with Foreign Saving

- Reliance on CA deficits along the growth trajectory
- The idea is to set i high to attract capital inflows (foreign savings) to support domestic saving, hence increase investment and growth
- Embedded in neoclassical theory
- (Some of the) problems:
 - Raises debt service burden
 - Financial resource curse
 - Susceptible to boom-bust cycles
 - Vulnerability to external financial developments
 - Finances consumption
- NDs argue that middle income countries do not need foreign capital to grow.

Getting the Exchange Rate Right

1. Structural reason

- The Dutch Disease

2. Policy reasons

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3. Political reasons

- Exchange rate populism
- Electoral accountability
- Tenure security
- Time inconsistencies

New Developmentalist position on fiscal policy

- Sound fiscal policy
- The composition of government spending (between gov cons & gov inv) matters
- Important role for fiscal policy to finance investment in healthcare, education, physical infrastructure
- The aim of fiscal policy should not be to stimulate aggregate demand except when is needed for short-run stabilisation
- Fiscal policy should be counter cyclical
- Important role in neutralising the Dutch Disease
 - Depreciation+ taxation + sovereign fund

Critiques of New Developmentalism

Critiques of New Developmentalism

- 1. Keynesian and Neo-Kaleckian critiques**
2. Internal economic logic critiques
3. Classical Developmentalism (CD) critiques
4. Fighting the last war critique

Keynesian and Neo-Kaleckian Critiques

I. **Export-led growth**

- Beggar-thy-neighbour
- Global deflationary dynamics
- Not likely to work when global demand is weak

II. **Wage-led growth**

- Antipathy to wage-led growth
- Justification of wage suppression
- No role is given to income distribution as a driver of capacity expansion

III. **Fiscal policy**

- Leaning towards fiscal austerity
- Apprehension about government activism
- Omission of concern with infrastructure; antipathy to tariff policy

Palley's other criticisms

- Lack of substance regarding what constitutes “right” macroeconomic prices
- What worked over the past forty years is unlikely to work in the future
 - The end of export-led growth strategy
 - Palley questions the relevance of the industrial sector for economic development (without any evidence to support this claim)
- Empirical relevance of the Dutch Disease for Brazil
- ND overlooks the adverse impacts of RER undervaluation.

CONCLUDING REMARKS

- Some of my thoughts on Palley's critiques
 - Agree with the vagueness about what is meant by "getting prices right"
 - Unfair account of ND on the role of state in the economy & unfair association with neoliberalism
 - Manufacturing sector continues to be an important engine of growth

CONCLUDING REMARKS

- The chief long-run growth challenge faced by developing countries concerns structural transformation
- The state has an important role to play in providing infrastructure investment
- (Financial) resource curse remains to be a relevant issue that require addressing
- Capital controls, taxing primary sector profits, exchange rate interventions
- Development policies should take changing global economic and institutional structure into consideration
- Global trade rules has narrowed the scope for using tariffs, quotas and export subsidies since the 1980s, the RER can be an important tool for structural transformation in this context.

Questions for Discussion

- What are the political economy constraints to implementing some of the New Developmentalist proposals?
- What are the potential adverse effects of RER undervaluation that New Developmentalists might be overlooking?
- What other reasons can you think that prevent countries from undervaluing their RER?
- Is emphasizing price signals over quantity signals a triumph of neoliberalism as Palley argues?
- Did the global economy entered the era of the twilight of industrialization as engine of development as Palley argues?
- Did or should export-led growth strategies come to an end?

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