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Introduction

In global capitalism, there is a myth that nation-states have lost autonomy and relevance. In reality, given the competition that characterizes globalization, nation-states have become less autonomous, but, as a trade-off, their role has become more strategic. On the other hand, while the conservative Right transformed globalization into a neoliberal ideology confirming the economic and cultural hegemony of the United States, left-wing militants viewed it as a manifestation of imperialism and as a major obstacle to economic growth. But both sides have been proved wrong, as several middle-income countries – particularly the dynamic Asian ones – have achieved fast rates of growth. This fact confirms the economic doctrine that middle-income countries that have already overcome the poverty trap can catch up because they can count on cheap labor and are able to copy or buy relatively cheap technology. Indeed, since the 1980s, these countries have experienced such impressive growth that it has come to be generally acknowledged that the economic center of the world is moving from the United States to Asia. In the 1990s, after the collapse of the Soviet Union, the United States appeared as the only hegemonic power and the growth engine of the world, but in the 2000s, this has proved no longer to be the case, as

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the impressive economic performance of the dynamic Asian countries has changed the world economic system. Yet a large number of emerging countries continue to record per capita economic growth rates inferior to those of the rich countries. Why does this happen? According to conventional neoclassical economics (whose hegemony is also in question for its repeated failure in explaining economic phenomena and orienting economic policies and for its responsibility for the 2007 global financial crisis), the cause is the lack of good institutions, particularly those that ensure property rights and contracts; according to conventional left-wing economics, it is because they lack industrial policies. In this book, I reject both explanations: neither the lack of institutional reforms nor the lack of industrial policy is behind such poor economic performance.

Instead, I propose three causes of such slow growth, one political and the other two economic. Middle-income countries fail to catch up (1) if, in the political sphere, they lack a nation strong enough to define a national development strategy and limit themselves to following rich countries' recommendations; (2) if, in the economic realm, their macroeconomic policies do not ensure a balanced budget, moderate interest rates, and a competitive exchange rate; and (3) if their income policies do not ensure that wages grow with productivity. This last problem is related to the fact that developing countries are defined by the existence of an unlimited supply of labor. Thus, wages tend to grow at a slower pace than productivity, which creates a chronic domestic demand problem, unless the ensuing concentration of income in the middle and upper classes is solved by the production of luxury goods and services. Latin American economists were already extensively discussing this question in the 1970s, when, in many countries, authoritarian rule was combined with increasing economic inequality; and with the transition to democracy, some countries like Brazil responded positively to the problem by increasing the minimum wage and social expenditures. For these reasons, I will not return to this issue in this book, even though the economic inequality problem is far from being satisfactorily dealt with

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in middle-income countries.[1] The first two problems are related to the distortions that the past thirty years of neoliberal ideological hegemony and financial globalization have imposed on the world economy. In this book, I first show how important a nation and a national development strategy are. Second, I show that the macroeconomic policies that are recommended to developing countries, particularly high interest rates and noncompetitive exchange rates, are inimical to growth. I argue that commercial globalization is an opportunity for developing countries insofar as it opens room for an export-led strategy, whereas financial opening is a curse. We are seeing now that the neoliberal deregulation of financial markets in rich countries, particularly in the United States, was disastrous for them as well. In the past, rich countries persuaded developing countries that they would be able to develop only with their financial support and that these countries should open their economies to international finance, but the rich countries kept their own domestic economies well regulated. In the past thirty years, however, the economic authorities of developed countries were persuaded that financial markets were efficient and that all markets self-regulate, and so they deregulated their economies. The major financial and economic crisis that was in full swing by 2008 is the outcome of this domestic financial liberalization coupled with financial globalization or liberalization. This book is not about the world financial crisis but rather about the reasons why many middle-income countries that have the necessary conditions for catching up did not do so, why their investment and growth rates were so modest, why their exchange rates tended to overappreciate, and why financial crisis was so frequent. The same financial globalization that

[1] In the 1970s, I devoted an early essay (Bresser Pereira [1970] 1984) and an entire book, *Estado e Subdesenvolvimento Industrializado* (Bresser Pereira 1977), to this subject, where I argued that the military regime sustained demand while inequality was increasing to the extent that the country's production was oriented to relatively sophisticated goods. This theme was present throughout the work of Celso Furtado (1963, 1965) and Maria da Conceição Tavares and José Serra (1972), and Edmar Bacha (1973) also wrote significantly on this subject.

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recently boomeranged in the rich countries had been causing disruption in the developing countries' economies and causing slow growth rates since they liberalized their foreign accounts in the early 1990s.

I discuss these issues in light of a historical-structuralist approach that has its sources in Keynesian macroeconomics, in classical political economy, and in development economics as it was understood principally in the 1950s. While the classical economists (and Schumpeter) understood the logic of capitalist development, Keynes added to it the demand side. From the 1940s to the 1960s, development economists combined the two approaches, focusing on a problem that economics had not treated before: the development of poor or underdeveloped countries. After the crisis of the 1970s, Keynesian and development economics came under attack from the new and dominant neoliberal ideology and from neoclassical economics, yet the early 2000s witnessed a revival of development macroeconomics that still, however, lacks a systematic formulation. This book intends to make a contribution in this direction. It sees Marshallian microeconomics as a useful methodological instrument for analyzing markets, while rejecting neoclassical growth theory, neoclassical finance, and neoclassical macroeconomics, which is apparently more scientific because it adopts a hypothetical-deductive method that permits full use of mathematics but that is inconsistent with a social science that aims to understand economic systems and, so, requires an empirical or historical method.[2] Besides being incapable of explaining the real world, neoclassical finance and macroeconomics are ideological castles built in the air that are of no use to economists (who do not use them for economic policy), but are useful in justifying the deregulation of financial markets that allows rentiers to accumulate artificial financial

[2] I see Alfred Marshall as one of the four or five major economists, together with Adam Smith, Marx, Schumpeter, and Keynes. His microeconomics, however, is not part of what I see as the hard core of economics – a science that aims to explain the behavior of economic systems – but of a secondary economic science (economic decision theory), side by side with game theory. On this, see Bresser Pereira (2009b).

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wealth, while leading the economy into financial bubbles and to recurrent crises. Neoclassical macroeconomist Gregory Mankiw (2006) well illustrated the pathetic irrelevance of neoclassical macroeconomics for macroeconomic policy making in the article "The Macroeconomist as Scientist and Engineer." I view this article as a confession of failure of this type of hypothetical-deductive macroeconomics. Mankiw, who was the chairman of the U.S. president's Council of Economic Advisors, begins his article by saying that during the two years he was in Washington, D.C., he was surprised that no one utilized the science as taught in the university. What policy makers and analysts do use is a collection of simple and pragmatic rules – a kind of engineering. Some pages on, however, he informs us that the economist who inspires policy makers in Washington, D.C., is John Maynard Keynes. He concludes by calling on "scientists" and "engineers" to get together.

Economists who have received neoclassical training in economics are certainly able to develop competent macroeconomic policies, but when they do so, it is a sign that they are not utilizing the economic theory that they have learned in their graduate courses. Instead, when they utilize methodological tools like econometrics, game theory, and certain parts of microeconomics, they combine them with Keynesian macroeconomics. Pragmatically, they abandon "science" and adhere to "engineering" – or, more precisely, they adopt the macroeconomic theory that is scientific.

In this book, I am not concerned with neoclassical economics or with the policies that economists adopt in developed countries but rather with the policy recommendations that rich countries, the North, offer their competitors – the middle-income or emerging countries. In other words, I am concerned with the Washington Consensus, or, as I have preferred to call it since the disappearance of the 1990s consensus in the 2000s, *conventional orthodoxy* – a body of knowledge developed by neoclassical economists. I am interested in criticizing the macroeconomic analyses, recommended policies, and political pressure originating in the North

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over developing countries. In many cases, the policy recommendations of conventional orthodoxy are substantially different from the actual policies conventional economists pursue in their own countries: they follow the "do what I say, not what I do" advice. This book is about development macroeconomics and a development strategy, but it also embodies a political economy approach. Although in the medium term, the interests of rich and middle-income countries coincide, in the short term, the fact that middle-income countries dispose of cheap labor often makes rich countries act collectively to neutralize middle-income countries' competitive capacity and to extract gains for their multinational firms. This behavior is seldom conscious or acknowledged, but it is the only explanation for the perverse content of conventional orthodoxy. Often the financial operations and investments involved are not in the interests either of people in developing countries, to whom, as we will see, they mean a mere substitution of foreign for domestic savings, or of people in rich countries, to whom they bring delocalization and reduced employment opportunities; however, they are in the interests of capitalist and professional elites in both types of country.

The central question addressed in this book is why, in global capitalism – a stage of capitalist development in which all markets are open and capitalist competition between business enterprises as well as between nation-states has become generalized – some developing countries are catching up while others are not. My answer is that those countries that are catching up have adopted a national development strategy that I call *new developmentalism*, whereas those that are falling behind have become subordinated to the North or to conventional orthodoxy. In opposition to old developmentalism, which, belonging to an earlier stage of economic development, presupposes a state-entrepreneur promoting forced savings, new developmentalism requires only a capable state and counts on markets and private entrepreneurial activity to achieve growth. The state is supposed to be the nation's main instrument of collective action, capable of organizing a nation around a national development strategy.

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New developmentalism has, as a basic long-term strategy, growth with domestic savings, not with foreign, and, in the short term, requires moderate interest rates and competitive or equilibrium exchange rates – precisely what sensible macroeconomic policies do in the rich countries, but the opposite of what conventional orthodoxy preaches.

For almost fifty years, I studied and taught economic development. The sources of my intellectual formation were development economics, Latin American structuralist theory, classical and Marxian political economy, and Keynesian macroeconomics. Today, I view myself as a Keynesian historical-structuralist economist who rejects mainstream neoclassical economics and any other orthodoxy whatsoever. I have been working on the ideas in this book since the early 2000s. Assuming that middle-income countries are supposed to present faster rates of growth than rich countries, I asked myself why, since the 1980s, this was happening only in some Asian countries, while the others fell behind. Gradually, I understood that the problem was neither the diminution of the size of the state, as the critiques from the Left claimed, nor the lack of further reforms, as claimed by the Right. The true causes were the lack of a national development strategy and a mistaken macroeconomic policy characterized principally by an overvalued exchange rate. Thus the problem was not the opposition between a hard, orthodox fiscal policy against inflation and a soft one; rather, the problem arose from the opposition between a growth policy privileging foreign savings and exchange rate populism, which appreciate the national currency, and an alternative policy based on domestic savings, fiscal or budgetary control, and the deliberate endeavor to neutralize the tendency to overvaluate the exchange rate. I knew that the exchange rate plays a strategic role in economic stabilization and growth, but the mechanisms that made it overvalued and inconsistent with economic development became clear to me only after 2001, when I began to systematically research the causes of the overvaluation. First, I criticized the policy of growth with foreign savings and explained why it does not usually cause growth but rather

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promotes, through the overvaluation of the currency, a high rate of substitution of foreign for domestic savings. Second, I realized that the Dutch disease is also a cause of overvaluation of the exchange rate, not only in oil-exporting countries but in practically all developing countries. After studying the problem with the help of students and assistants, I arrived at a central thesis or hypothesis: that the main obstacle to catching up faced by middle-income countries is the tendency to overvaluate the exchange rate – a tendency that economics still ignores and that conventional orthodoxy will probably dismiss. The latter admits that the exchange rate is volatile but believes that eventually it varies around the equilibrium price, while my contention is that if the tendency to overvaluate is not neutralized, market control will be expressed as a balance-of-payment crisis and a sharp depreciation of the national currency. There is a second structural tendency that is also an obstacle to growth – the tendency of wages to grow at less than the productivity rate because of the existence of unlimited supply of labor in developing countries – but the ensuing insufficiency of demand problem is often "solved" through the increase of luxury goods by the rich.

Conventional orthodoxy is the adversary that I criticize in this book. It is the Washington Consensus in the form in which it continues to be applied, even if its failure has eliminated the quasiconsensus existing since the late 1980s. It includes the sum of diagnoses, recommendations, and pressures that the North directs to developing countries. I call it "orthodoxy" because its adherents view it so. Yet whereas in the developed countries, this means fiscal austerity, moderate interest rates, and competitive exchange rates, Washington, D.C., and New York preach the exact opposite to developing countries, namely, high interest rates to fight inflation and overvalued exchange rates, also to fight inflation and to attract foreign capital. Despite its rhetoric of fiscal austerity, the conventional orthodoxy, in practical terms, adopts a soft fiscal policy so as to keep the internal debt high and thus remunerate the financial rentiers who hold local treasury bonds with high interest rates.

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In fact, conventional orthodoxy suffers from the disease that it attributes to politicians in developing countries who lead the state to spend more money than it receives. It is populist not only from a fiscal standpoint but also and principally from an exchange rate standpoint insofar as it stimulates domestic consumption, rather than investment, by arguing in favor of policies that cause the local currency to appreciate. Conventional orthodoxy is a counterstrategy to growth that eventually neutralizes a country's competitive capacity. I do not discuss the political economy of this ideology, but it is the outcome of an informal political agreement between, on one hand, local financial rentiers and a domestic financial system that benefits from high interests and, on the other hand, multinational enterprises and competing countries that benefit from an overvalued local currency. The Bretton Woods international financial agencies act as intermediaries in the name of their controllers – the rich countries. The latter have reserve currencies, which limit their capacity to manage the exchange rate. It is principally for this reason that conventional orthodoxy insists that in the long term, it is impossible to manage the exchange rate, and rich countries rebuff the attempts of developing countries to neutralize the tendency of their exchange rates to overappreciate.

This book deals with middle-income or emerging countries that, today, together have almost five billion habitants and are divided between those countries that have succeeded in catching up and those that have not. The other two billion of the world's inhabitants are divided between the poor and the rich countries. I do not discuss the poor countries because their problems are different from those of the middle-income countries. They have low levels of education, noncohesive societies, weak states, and political elites that are often corrupt and have yet to undertake their capitalist revolutions. For the moment, they lack the capacity to compete with the rich countries that are interested in their mineral wealth. It is very important to discuss the policies that are necessary to enable these countries to overcome poverty, if not misery, and the ideas

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discussed in this book concerning national development strategies and exchange rates are applicable to them. But the diagnosis and the policies that are relevant to these countries are different from those applicable to middle-income countries.

In the seven chapters of this book, I develop two arguments that I believe to be simple. In Part I, I discuss the political economy of catching up. All middle-income countries are already capitalist societies that tend to grow at reasonable rates, but, while some are successful in catching up because they have adopted a national development strategy that I call new developmentalism, most of them display modest growth rates because they have subjected themselves to conventional orthodoxy. New developmentalism differs from old developmentalism because it attaches more importance to macroeconomic policy than to industrial policy, and it differs from conventional orthodoxy because it rejects the policy of growth with foreign savings and proposes a macroeconomic policy based on fiscal austerity, moderate interest rates, and competitiveness obtained through the neutralization of the tendency to overvaluate the exchange rate. In Part II, the theme is the development macroeconomics of the exchange rate. I focus on the exchange rate because I believe that it is the strategic macroeconomic variable in economic development and also because I developed my research around it during the past nine years.

In Chapter 1, I discuss globalization and catching up and argue that, contrary to what neoliberal globalism asserts, nation-states have not lost their relevance but rather have become more strategic because the increased interdependence that characterizes globalization originates in the intense competition they face. This competition takes place not only among business enterprises, for profits and expansion, but also among nation-states, for higher rates of growth. The discussion presupposes that the competition between rich and middle-income countries is a game with positive-sum outcomes, but in the short term, some players gain

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