TEN THESES ON NEW DEVELOPMENTALISM

On May 24 and 25 of 2010, a group of economists sharing a Keynesian and structuralist development macroeconomics approach convened in São Paulo to discuss ten theses on New Developmentalism – the name that some of them have been using for some years to describe the national development strategy that middle income countries are today using or should use to promote development and economic catching up.

The meeting was part of the **Financial Governance and the New Developmentalism** project, financed by the **Ford Foundation**. The project has as its background the failure of the Washington Consensus to promote growth in Latin America and the 2008 Global Financial Crisis that showed the limits and dangers involved in financial globalization and financial deregulation.

The workshop was held in the aftermath of the biggest financial crisis in history in which was evident the impact of open capital markets on exchange rates and the prices of tradable goods. G20 and individual countries are now building the required regulation of financial markets. Given that and the repeated financial crises in middle income developing countries, the general objective of the workshop was to evaluate how effective a new developmentalism strategy might be in promoting growth with stability. The specific objective was to discuss ten theses on new developmentalism that participants had been asked to think about in advance of the meeting.

After two days of lively discussion, the local organizers of the workshop were charged with editing the theses to reflect the debate. The final version has now been endorsed by the original participants of the workshop. Other economists and social scientists committed to the idea of economic growth with stability and social equity are now also invited to subscribe.

1. Economic development is a **structural process** of utilizing all available domestic resources to provide the maximum environmentally sustainable rate of capital accumulation building on incorporation of technical progress. The primary objective is to provide full employment of available labor resources. Not only should this involve increasing productivity in each industry, it also involves finance and the continuous transfer of labor to industries producing goods and services with higher value added per capita and paying higher wages and salaries.

2. Markets are the major locus of this process, but the **state** has a strategic role in providing the appropriate institutional framework to support this structural process. This includes promoting a financial structure and financial institutions that channel domestic resources to the development of innovation in sectors that produce high rates of increase in domestic value added. This framework should also include measures aimed at overcoming structural imbalances and promoting international competitiveness.

3. In the context of globalization, economic development requires a **national development strategy** which seizes global opportunities i.e. global economies of scale and multiple sources of technological learning, mitigates barriers to innovation created by excessively strong intellectual property regimes, assures financial stability, and creates investment opportunities to private entrepreneurs.

4. Although the Schumpeterian side of the development process and strategic industrial policy are relevant, **the demand side is where the major growth bottlenecks unfold.** Since Keynes it has been widely recognized that supply does not automatically create demand. However, in developing countries there are two additional structural tendencies that limit demand and investment: the tendency of wages to increase at rates below the growth of the productivity, and a structural tendency to overvaluation of the real and/or nominal exchange rate.

5. The **tendency of wages to increase more slowly than productivity growth** is due to the existence of an abundant supply of labor and of the political economy of labor markets. Besides limiting domestic demand and reinforcing income concentration in the higher classes, this tendency can also affect long term productivity growth negatively. A legal minimum wage, cash transfers to the poor, and principally a government guarantee to provide employment at a living wage could be used to neutralize this tendency to underpay labor. The alternative – chronic overvaluation of the national currency that increases purchasing power– is not a sustainable strategy.

6. The **tendency to cyclical overvaluation of the exchange rate** in developing countries has been due to both the excessive reliance on external savings in the form of foreign capital flows and the Dutch disease in the context of excessively open capital markets and lack of appropriate regulation. This tendency implies that the exchange rate in developing countries is not just volatile, but it also contributes to recurrent currency crises and recurrent bubbles in the financial markets. It also implies that export oriented investment opportunities are chronically insufficient because exchange rate overvaluation renders even the most efficient business enterprises uncompetitive internationally.

7. **Dutch disease may be characterized as** a **permanent overvaluation** of the national currency due to Ricardian rents originated from the export of commodities based on natural resources or exports based on ultra cheap labor. Dutch disease impedes other tradable industries from prospering. It does so by creating a wedge between the "current account equilibrium exchange rate" (the exchange rate that balances the current account) and the "industrial equilibrium exchange rate" – the exchange rate that allows tradable industries to be competitive utilizing state-of-the-art technology.

8. Economic development should be **financed essentially with domestic savings.** In order to achieve this goal, the creation of public financial institutions to ensure full utilization of domestic resources, in particular labor, finance innovation and support investment is required. The attempt to use foreign savings via current account deficits usually does not increase the investment rate (as claimed by orthodox economics), but instead increases domestic indebtedness and reinforces financial instability. Growth strategies that rely on foreign savings cause **financial fragility**; get governments caught up in regressive

"confidence building" games; and, all too often end with a balance of payments or currency crisis.

9. In order to provide the appropriate framework for development the government must ensure a **stable long term relation between the public debt and GDP** and a **real exchange rate** that takes account of the need to counter the adverse effects on the manufacturing industry of Dutch disease.

10. To achieve long term development **economic policies** should pursue **full employment** as its primary goal, while assuring price and financial stability.

These ten propositions are not intended to be a comprehensive recipe for development. Rather they are intended to be a set of propositions that a wide array of economists can subscribe to. These propositions should be adjusted according to a proper mix, specific to each domestic productive, social and political context. Nothing has been said about the global financial and trade architecture which are clearly matters that need attention in the new environment of globalization that binds economies so closely together, often in forms of adverse competition.

The economists that subscribe this document are not saying that they agree fully with all its ten theses. They are just saying that they support its theoretical approach and main policy recommendations.

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