Science versus intuitive knowledge

Luiz Carlos Bresser-Pereira
Folha de S. Paulo, April 9, 2012

It is not surprising that the fast-growing Asian countries try to manage their exchange rate and not to incur current account deficits

Economic theory is a simpler science than presuppose its neoclassical or orthodox supporters. The whole mathematics they use to develop their models divorced from reality, apart from being unnecessary, is damaging, because it leads them to turn the market into a myth, and to propose its deregulation, with serious financial crises as the outcome. But this doesn't mean that the economic theory is a set of intuitive knowledge. On the contrary, as it happens with the other sciences, it only becomes innovative when it breaks with common sense. Adam Smith rejected common sense when he said that the wealth of a nation did not lie in its gold and in its temples, but in production; Marx, when he showed that profit resulted from an exchange of equivalent values in the market; Schumpeter, when he taught that the decisive factor for the economic development is not the entrepreneur's ownership of capital, but his ability to innovate and to have access to credit; Keynes, when he argued that it is investment that determines savings.

Today, economists face a puzzle. Intuition tells them that “capital-rich countries should transfer their capital to capital-poor countries”, which means that developing countries should incur current account deficits and finance them with loans or direct investments. However, the fast-growing Asian countries, that grow much more rapidly than Latin-American countries, usually present a current account surplus (trade surplus including services, interests and dividends); China always does it.

During the Lula administration, Brazil presented a higher growth rate when it had a current account surplus; since it went back to the deficit, it has been growing less. In most cases, a developing country will grow more if it shows current account surpluses and, thus, finances the rich countries. The Dutch disease model explains this surprising truth. For a country to neutralize the Dutch disease or the curse of natural resources, it must shift its current equilibrium exchange rate (which brings its current account to zero) to the industrial equilibrium (the exchange rate that makes enterprises using world state-of-the-art technology competitive). By achieving this shift, the country shall have, by definition, a current account surplus, and the rich countries shall incur deficits.

Developing countries should not, therefore, try to grow with foreign savings, but with foreign dissavings or current account surpluses. A second argument in the same direction shows what usually happens with a country that tries to grow with foreign savings. Capital inflows necessary to finance this deficit appreciate the exchange rate, increase artificially actual wages and consumption, so that even when they are represented by direct investments, they ultimately increase consumption rather than investment. And the country, in addition to sending profits and interests abroad, is

later threatened by a balance-of-payment crisis. It is not surprising, therefore, that the fast-growing Asian countries, which pay far less attention than we do to the advices of Northern orthodox economists and financiers, try to manage their exchange rate and not to incur current account deficits, but rather current account surpluses. Should Brazil also have a surplus, it would grow much more and much more safely than it grows today.