No foreign finance, please

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Countries should avoid foreign finance
(finance in foreign currency)

- Sovereigns just don't need and should not accept finance in foreign currency

- Governments should limit indebtedness of their nationals (families and business enterprises) in foreign currency.

(A foreign currency is a currency that you are not able to print)

"The original sin"

- This was the name that Barry Einchengreen gave to indebtedness in foreign currency.
- It is a good name.

A political reason:

a sovereign state may only borrow
in its own money

- This is a condition of sovereignty;
- In the moment that a state borrows in foreign money it is renouncing its independence.

Economic reasons
(assuming the foreign finance implies current account deficits)

- 1. A competitive exchange rate is required for growth
- 2. Current account deficits imply overvalued currency;
- 3. The "foreign constraint" does not exist
- 4. Dutch disease countries are supposed to have a current account surplus;
- 5. The infernal growth with foreign savings path.

1. A competitive exchange rate is required for growth

- In relation to growth, the exchange rate is a <u>"light switch"</u>: it connects or disconnects competent firms from world demand.

2. A current account deficit implies an overvalued currency,

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- In a market economy, the decision of growing with foreign savings, or of incurring in current account deficit, makes the national currency more appreciated than it would be in the case of balanced or zero current account: makes it overappreciated.

- Exception: if the country is growing fast and the current account deficit is inferior to the growth of exports.

3. The “foreign constraint” does not exist

when the exchange rate is in equilibrium.

- The foreign constraint thesis and the two gap model reflect the fact that in developing countries the exchange rate is chronically overvalued.
- The Thirwall Law is perfect, provided that we don’t deduce from it the policy of recurring to foreign savings to overcome the export growth limitation.

4. Dutch disease countries are supposed to have a current account surplus

- A country confronts Dutch disease when the the "industrial" current account equilibrium of the exchange rate is more depreciated than the "current" equilibrium.
- To neutralize the Dutch disease means to shift from the current to the industrial eq.
- This shift implies necessarily a current account surplus.

5. The infernal growth with foreign savings path

A. high rate of substitution of foreign for domestic savings

   (increased indebtedness instead of increased investment);

B. foreign financial fragility

   (and ensuing “confidence building policy”);

C. currency crisis.

End

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The abstract of what I was supposed to say today

- The alternative to neoclassical economics is a Keynesian-structuralist approach – a structuralist development macroeconomics.

- The alternative to the Washington consensus policies and reforms is the new developmentalism – a national development strategy.
- I confirm all this, but I will limit myself to one topic.