

## **Macroeconomics for Development Convergence in Emerging Economies**

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### **Synopsis**

There is a broad consensus that macroeconomic 'fundamentals' are a most relevant variable to enhance economic development. However, there is wide misunderstanding about (i) what constitutes "sound fundamentals", (ii) how to achieve and sustain them, and (iii) what macro approach contributes better to sustained high economic growth..

The approach that has been in fashion in the mainstream world and IFIs emphasizes macroeconomic balances of two pillars: low inflation and fiscal balances, with a clear omission of the overall macroeconomic environment for producers, which includes other most influential variables such as aggregate demand and interest and exchange rates. We call it financial macroeconomic balances. As a consequence, in many LACs the coexistence of "a sound macroeconomics" (low inflation and small public deficits or surpluses) is observed, in parallel with slow growth and high unemployment of labor and of productive capital resulting from unstable aggregate demand and outlier interest and exchange rates.

The standard approach evidently includes other ingredients, but assumes, that the hard, relevant, proof is in fulfilling those two pillars. That leads to achieving productive development if the economy is liberalized, or that it suffices with the addition of microeconomic reforms. Additionally, a frequent assertion in the more recent conventional literature is that an open capital account imposes macroeconomic discipline to emerging economies (EEs). Indeed, this approach assumes, sometimes explicitly or frequently implicitly, that full opening of the capital account would contribute to impose external and fiscal balances and automatically generate an aggregate demand consistent with productive capacity: it is well documented that that is not the usual experience in the frequent cases of external, positive and negative, financial shocks experienced by EEs.

Naturally, even though insufficient and frequently achieved in a fashion unfriendly with development, concern on those two financial balances is justified. In particular, Latin America suffered of hyperinflation processes, many times led by public

deficits out of control, with pervasive effects on economic and social development. LACs were successful in the 1990s in reducing inflation to one-digit figures, and balancing their fiscal budgets (fiscal deficits averaged, of course with diversity among countries, between 1 and 2% of GDP in 1994 and 1997, the two years preceding the two recessive shifts of the 1990s). Expansions of the money supply to finance public expenditure had become weaker or disappeared. In fact, several LACs fulfilled the main requirements of neo-liberal macroeconomic balances.

But, there is strong evidence that financial macroeconomic balances have provided a macroeconomic environment that has not achieved a high and sustained growth. A third pillar must be added, linked to the productive side of the economy. The behavior of aggregate demand, at levels consistent with potential GDP (also called productive capacity, installed capacity or production frontier), is a crucial part of a third pillar of real macroeconomic balances, which has frequently failed in neo-liberal experiences. As well, are well-aligned macroprices, like interest and exchange rates. Frequently, these prices and aggregate demand were outliers (out-of-equilibria), as reflected in economies working either below potential GDP (the most frequent result) or, at full capacity but with a booming aggregate demand and a large external deficit (a more sporadic condition since 1980).

This article will widen the view on macroeconomic balances by taking into account the macroeconomic incentives faced by firms and workers in the productive side of the economy (the producers of GDP), analyzing also the relationship between financial and real variables, and the *social* effects of macroeconomic policies. We will analyze the role of alternative structural countercyclical fiscal policies, intermediate exchange rate policies, and examine alternative capital account approaches.