

# ECO 403 – L0301

## Developmental Macroeconomics

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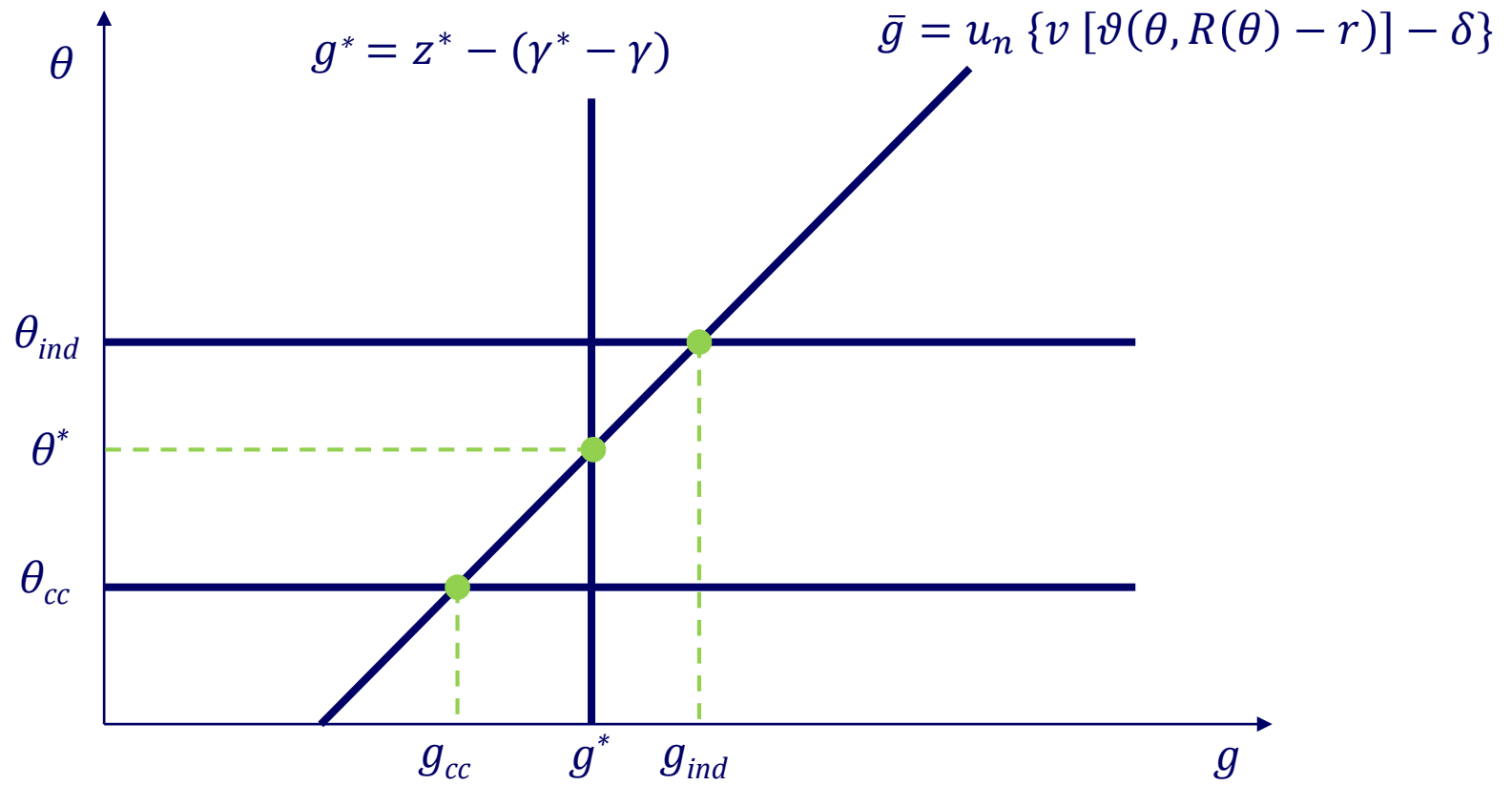
### Lecture 12

## The Transition to a High-Development Regime

# Falling Behind Due to Dutch Disease

- If ***Dutch disease*** is not ***neutralized***, the currency becomes overvalued and  $\theta_{cc}$  becomes the equilibrium ***exchange rate***
  - But  $\theta_{cc}$  does not allow to close the per capita ***income*** gap with developed countries
  - Where  $\theta^* > \theta_{cc}$  allows per capita ***income*** just to grow at the same pace as in developed countries
- With ***Dutch disease***, a ***premature*** process of ***deindustrialization*** takes place
  - This is due to the ***exchange rate*** not being kept at the ***industrial*** equilibrium level ( $\theta_{ind}$ )
  - Therefore, ***Dutch disease*** needs to be ***neutralized***

# Falling Behind Due to Dutch Disease



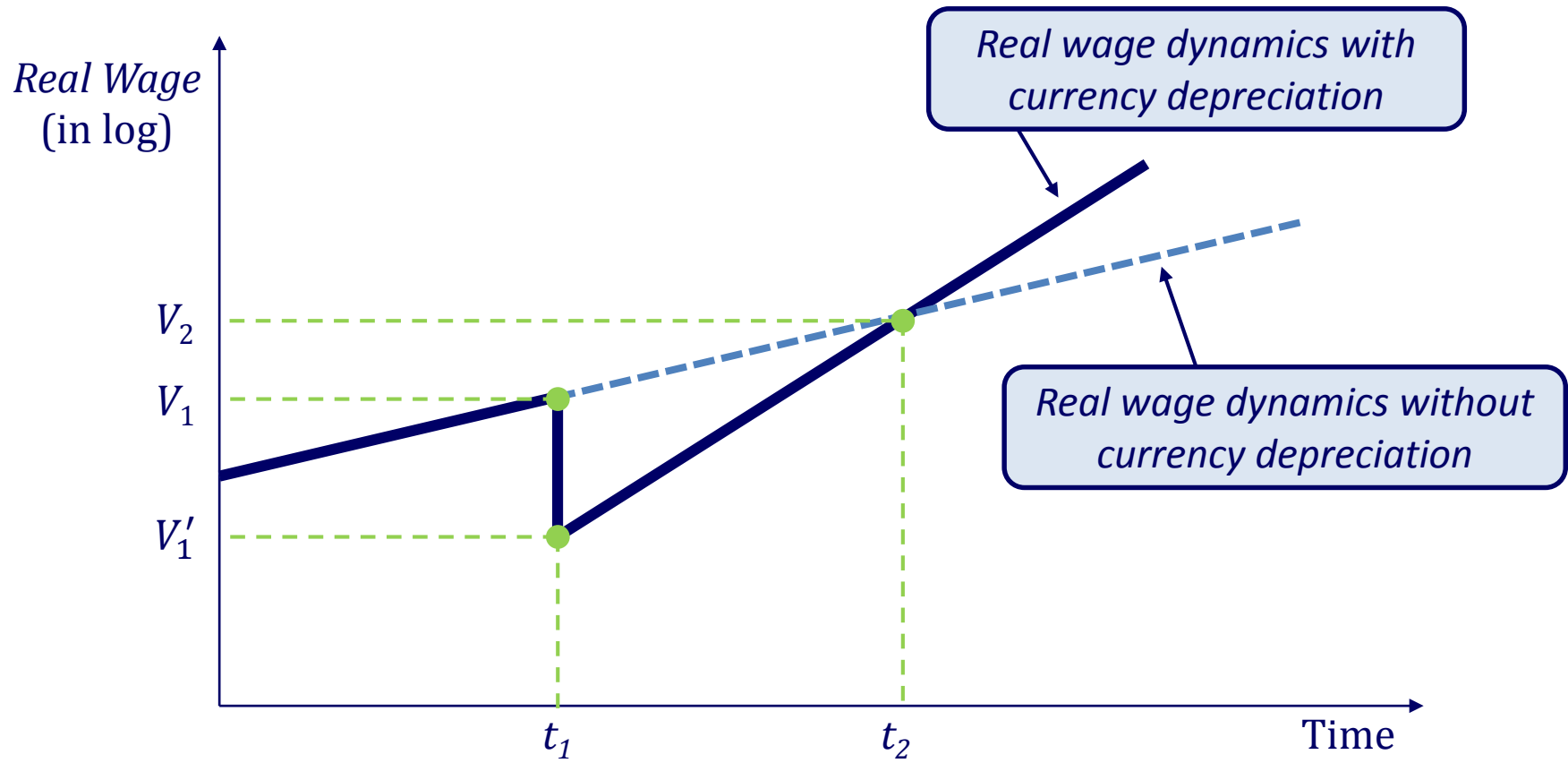
# Breaking the Low-Growth Equilibrium

- **Neutralization** of *Dutch disease* and *exchange rate policy* allow the economy to move into a high-growth trajectory
  - Imposition of an *export tax*
  - Purchasing *foreign currency* and controlling *capital inflows*
- Initial impact includes a decrease in *real wages* (and *consumption*), decrease in degree of *capacity utilization*, acceleration of *inflation*, and an increase in *unemployment*
- In the medium run, increase in *exports* and *investment* leads to higher rate of *growth* (and *unemployment* falls)
- Greater *growth* and higher rates of *investment* increases labour *productivity* (allowing increases in *wages*)

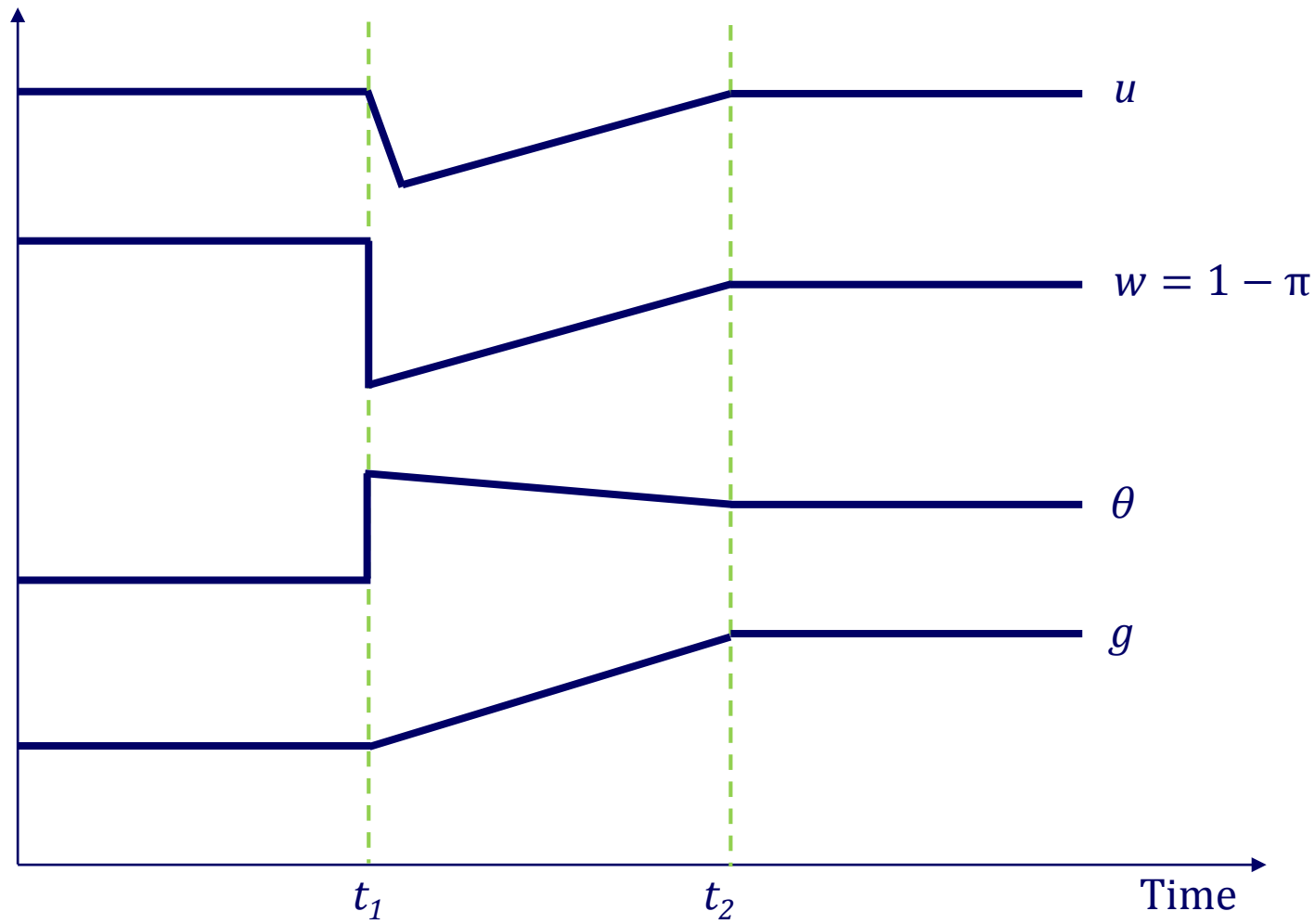
# Process of Reindustrialization

- Strong currency **depreciation** impacts both the **productive** (supply) side and the **demand** side of the economy
- On the **productive** side: process of **reindustrialization**
  - Gradual increase in income elasticity of **exports**
  - Gradual decrease in income elasticity of **imports**
  - Increase in the **growth** rate of output compatible with balance-of-payments equilibrium
- On the **demand** side, two main effects:
  - Decrease in **real wages, consumption, and capacity utilization**
  - Increase in **exports**
  - Over time the second effect outweighs the first one and **growth** rate rises

# Real Wages and Currency Depreciation



# Dynamics After Currency Depreciation



# Importance of a Developmental Strategy

- Role of the *nation*
- Importance of the *state* and *industrial policy*
- *State* complement the *market*
- Economic *growth* implies *industrialization* and productive *sophistication*
- Importance of *exports* of *manufactured* goods
- Trade *liberalization* as long as exchange rate *competitive*
- *Growth* with *distribution*