Global imbalances, empowered finance, and neoclassical mechanism designs: Consequences for global-South development strategy

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1. Introduction: "New developmentalism" meets the global financial crisis

The global economy is at a flex-point that would have been unimaginable just a decade ago. The economies of the global-North are, almost without exception, floundering in recessionary conditions without the political will to create the sort of stimulus that would lift them from stagnation. The most likely outcome is that stagnation of the sort that has trapped Japan since the 1990s will spread across Europe and the United States, with as-yet unimaginable consequences for the character of political leadership in the decade to come. Yet at the same time, economies in the global South are poised for success. Indeed, the BRIC nations – Brazil, Russia, India, and China – have all achieved strong rates of economic growth in the mid-2000s, and all these nations' growth has thus far only been moderated affected by the slowdown in the global North.

The success of these and other global-South economies reflects what Bresser Pereira (2010) terms the "new developmentalism," at the heart of which is a national development strategy. The specific strategies deployed by different developing nations vary based on the historical circumstances, resource endowments, and industrial configurations that have been inherited from the past. The very notion of a national strategy for development already reflects the surging strength of these nations, many of whom were forced to dismantle their planning agencies and/or to liberalize their domestic markets, often under International Monetary Fund (IMF) supervision, during the profound crises of the 1980s and 1990s. However, these trials led to policy experiments based on a critical reassessment – in light of the many global-South financial crises of those first two decades of the neoliberal era – of the elements required for economic growth.

A key step in virtually every nation has been a rejection of the liberalization/free-trade policy regime advocated by the IMF and by efficient-market proponents. Trade has its place, as does liberalization, in the new developmentalism; but the trials and crises of the 1980s and 1990s show that these elements must be incorporated into development strategies that include government infrastructure investment, industry-targeting, and the creation of viable industrial clusters. No "one size fits all" strategy is to be had; instead, each nation has to begin with its own economic structure and its own insertion into the global economy in assessing a basis for its own growth. This new

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thinking about development – much of it admittedly revitalizing ideas that had been discussed by the generation of Furtado, Prebisch, and Hirschman – was spurred initially by the pioneering texts of Amsden (1992) and Chang (2002). It was boosted by new thinking in the realms of economic theory and strategy, which emphasized competitive advantage (Porter 1998), increasing returns to scale (Helpman and Krugman 1987) and path dependence and industrial clusters (Arthur 1994). Recent years have seen a new wave of development writing, including Bresser's book, that have opened the space for post-orthodox, pro-institutionalist thinking about development; to name just a few, Chang (2008), Amsden (2003), Reinert (2008), and Rodrik (2008).

It is worth noting that a number of these texts were published in 2008 – the very year in which the global financial crisis engulfed the US and UK financial sectors and pushed the global North into recession. As noted, as this great crisis moved on to engulf Europe, it has put in motion some forces whose full extent has yet to be seen. This essay considers the implications of the great financial crisis for global-South development strategy.

We argue here that the direction of global-North reactions to this crisis period have already been pre-figured in the trajectory of global-North economic policy during the neoliberal era. In effect, while the economies of the global South were hit – and reshaped, in different ways – by successive waves of financial crisis, so too, the economies of the global North were reshaped in these years. This reshaping involves an interaction between three factors: first, the structural global flow-imbalances that emerged in the 1980s; second, the growth of an increasingly empowered global financial sector; thirdly, the creation of a series of neoliberal mechanism designs that have locked in global-North national economic policies in various ways.

This article concludes by reflecting on the implications of this global-North reshaping, in the midst of the great financial crisis. We do this by focusing on a key problem confronting the Brazilian economy: its overvalued exchange rate. We argue here that global-North policy reactions to the extended period of global crisis impose serious constraints on Brazil's policy options for dealing with its overvaluation problem. Consequently, any effort to deepen the new-developmentalist approach must have "eyes wide open" regarding the difficult policy terrain that global-North crises have now created for global-South nations seeking escape from their long histories of dependent development.

2. Financial globalization, 1980s to 2000s

The neoliberal era came into being step-by-step after the collapse of the Bretton Woods system in 1973. The dollar remained the most important reserve and global-transaction currency, but the willingness and capability of US authorities to order global financial transactions was much diminished. One immediate implication of these developments was the multiplication of financial risks; and with those risks emerged an entire new set of speculative currency markets. These markets grew rapidly, due to their peculiar two-sided character: on one side, futures, options, and derivatives contracts could provide hedges – in effect, insurance – for firms exposed to exchange-rate risk; on the other, those providing this insurance could bet on market volatility.

One other implication of the end of Bretton Woods – amplified by two successive 1970s oil-price shocks – was an upward shift in nominal (and real) interest rates and an extended period of macroeconomic stagnation. Banks lost deposit customers to disintermediation and loan-market customers to commercial-paper and bond markets. Large banks compensated by expanding their loan-making – and thus their cross-border default and exchange risks - to nations in the global-South, especially in Latin America.

By the end of the 1970s, the U.S. and global macroeconomies were in disarray. President Carter turned in 1979 to New York Federal Reserve President Paul Volcker to restore order as Federal Reserve chief.2 The Federal Reserve killed off inflationary pressure by contracting base-money growth. Interest rates shifted upward radically: recession ensued, the dollar climbed against other currencies, and oil prices crashed. As a result, Latin American nations could not meet their payment commitments, the US savings and loan system crashed, and US banks in oil-rich states failed, taking Continental Illinois with them.

However, these parallel episodes of financial distress were accompanied by very different macro-growth outcomes. Latin America's economies went into reverse, and the region entered a "lost decade" of stagnation. By contrast, US macroeconomic growth recovered, fueled the nation's "twin (government and current-account) deficits." In effect, the combinations of US growth and stagnation elsewhere, the high dollar, and the dollar's status as global reserve currency introduced a new period, in which capital flowed systematically into the US. This structural situation was self-reinforcing, and based on a view that the rest of the world would accept as many dollars as the U.S. emitted, recycling the majority in US asset markets. This global pattern had been established with the "petro-dollar recycling" of the 1970s. This view was justified in various ways. In one view, the US had moved on from manufacturing to higher-value-added activity in services. In a second, the US had a global comparative advantage in consumption. In a third, the US was a "safe haven" in an unstable global economy.

The third rationale was reinforced several times in subsequent years. In 1990, Japan's rapid growth was undermined by the bursting of its equity-market/land-price bubble, throwing that nation – once a contender for global economic leadership with the US – into an extended period of stagnation. Then in 1994-95, the "Tequila crisis" hit Mexico and caused substantial instability in that nation's financial markets and real economy. Next, the Asian financial crisis in 1997 brought the rapid ascent of East Asian nations to a halt. Then came the Russian ruble/Brazilian real crisis in

[2] In Volcker's view, U.S. monetary policy should intervene strategically to advance "national policy." Volcker observed in a 1979 publication that "a controlled disintegration in the world economy is a legitimate objective for the 1980s." Specifically, he wrote, "It is tempting to look at the market as an impartial arbiter .. But balancing the requirements of a stable international system against the desirability of retaining freedom of action for national policy, a number of countries, including the U.S., opted for the latter" (Volcker 1979, p. 4).

1998-99, linked to the failure of the Long Term Capital Management hedge fund. The peaking of the IT bubble in asset markets in March 2000 and the destruction of the World Trade Center in September 2001 continued the cycle of boom/bust and instability. The thematic established in the 1980s crises held steady: crises that involved US markets or institutions were quickly resolved, while other crises led to downturns.

Table 1: Market value of largest 1000 global firms by equity value, 1989-2010

	1989	1997	2001	2004	2010
US					
US Financial sector	261.3	1,182.1	2,244.7	4,024.6	1,763.3
US Non-financial sector	1,546.7	4,241.3	7,307.7	6,750.8	6,548.7
Fin % Non-fin	16.9	27.9	30.7	59.6	26.9
Rest of World					
ROW Financial sector	1,328.5	1,919.0	2,240.0	2,450.7	6,720.5
ROW Non-financial sector	1,562.1	2,531.6	4,280.8	8,242.7	11,195.1
Fin % Non-fin	85.1	75.8	52.3	29.7	60.0
US % World:					
Financial sector	19.7	61.6	100.2	164.2	26.2
Non-financial sector	99.0	167.5	170.7	81.9	58.5

Sources: Business Week "Global 1000" Rankings, May 1989, May 1997, May 2001, May 2004; Fortune Global 1000, March 2010. The financial sector includes banks, financial companies, public funds, and insurance companies.

For these interconnected reasons, the US financial markets systematically absorbed capital inflows from elsewhere in the world. That is, the global structural imbalances had profound effects on the distribution of global financial power. Table 1 illustrates the shift in the dollar market value of equity outstanding for the 1,000 largest global firms (by market value) for several points between 1989 and 2010. The data are divided between firms headquartered in the US and in the rest of the world, and in turn between financial and non-financial firms. Note first that within the population of US firms in the global 1000, the value of financial sector firms equaled just 17 percent of non-financial firms in 1997, but then grew steadily until reaching 60 percent in 2004. An opposite trend was at work in companies from the rest of the world in the global 1000: financial firms accounted for 85 percent of non-financial firms' value in 1997, but only 30 percent in 2004.

More remarkable is the relative growth of US versus rest-of-the-world firms in this elite category. Across all non-financial sectors, US firms' equity value equaled that in the rest of the world in 1989, exceeded it considerably in 1997 and 2001, and then plunged to earth by 2004; the impact of the puncturing of the IT bubble is evident. By contrast, the equity value of US financial firms in the Global 1000 equaled just 20 percent of the value of (Global-1000) financial firms elsewhere in

1989. US financial firms' relative value then grew steadily, pulling equal with the rest of the world in 2001 and exceeding it by 64 percent in 2004.

While capital was flowing systematically into the US, the US financial system was being deregulated. Legislation passed in 1980 began the process of deregulating U.S. commercial banking. Two years later the deregulation of thrifts was initiated, and a series of acts through the 1980s and 1990s continued the process of dismantling Depression-Era restrictions on product-line and geographic competition, and ultimately on the character of financial conglomerates.

A bank merger wave paralleled these events: many failed thrifts and oil-patch banks were absorbed by healthy commercial banks (Dymski 1999). The segmented US banking system was quickly reconfigured through consolidations: by the 1990s a set of "super-regional" banks (NationsBank, Wachovia, First Union, Bank of Boston, Banc One, Wells Fargo, and so on) emerged with multi-state branch networks. These super-regional banks' growth spurred competition with the remaining money-center banks and led to further financial mergers. One of these – the planned merger of Citibank with Travelers Insurance – triggered the passage of the 1999 Gramm-Leach Bliley Act, which finished the process of bank deregulation by rescinding the Glass-Steagall Act and permitting the creation of financial holding companies that could combine insurance, investment-banking, and commercial-banking activities. As DeFerrari and Palmer (2001) observed, large banks were increasingly dominating US banking – the ten largest grew from having 26 percent of all banking assets in 1989 to 49 percent in 1999. Further, large banks had ever more derivatives positions, were involved with every more non-bank banks, and were continually expanding their global reach. This same trend was occurring globally.

3. Neoliberal mechanism designs[3]

The 1980s saw the emergence of a global neoliberal order dominated by the largely unchecked power of large multinational corporations, and by the increasingly free flow (or the threat or promise of the free flow) of capital across borders. This era was also characterized by the reduced power of national states vis-à-vis market forces. Governments world-wide focused on market and financial deregulation; each government was, in effect, freeing its financial and non-financial sectors to compete globally. At the same time – and not surprisingly – nation-states in the neoliberal era have been unable to establish rules for cross-border economic flows; they have had difficulty in stabilizing income and expenditure flows at levels insuring that residents within their borders have secure and broadly-prosperous lives; and they have been unable to support public services at levels that improve human welfare.

The key assumption is that we exist in a world in which stationary geographic units must compete for globally mobile capital. The rules for successful 'competitors' are: to permit free entry/exit of

[33] This section builds on – and borrows several sentences from – two sections in Dymski (2011).

capital; to maximize potential return for capital-providers, in part by shifting risks off of these firms and onto third-party insurers or government itself ("bailout" mechanisms); and to have resolution mechanisms ready in case of problems.

While the neoliberal world lacks a hegemon of unchallenged strength, it remains comprised of stronger and weaker nations and regional zones. Economic resources broadly conceived - product markets, non-renewable resources, final-goods demand, and sources of capital and credit, to name only several – were all unevenly distributed across global economic space after the Bretton Woods system broke down: each resource was spatially-differentiated, with areas of plenty and scarcity. Players within this spatially-fragmented world order are stronger insofar as they control the use of, or access to, scarce resources that consistently command economic rents. However, the two most important categories of global players – nation-states and large global corporations – have different impulses vis-à-vis this uneven map.

Nation-states with concentrations of multiple economic resources as defined above try to control access to their markets. Nation-states without them – in conjunction with "footloose" corporations – try to capture rents by accessing national markets with prosperous consumers. The latter strategies, facilitated by the Thatcher and Reagan "revolutions," led to the rise of the global factory in the 1980s. Large corporations, in turn, increasingly seek profits by engaging in arbitrage, across many fronts: in effect, these players arbitrage exchange rates; they arbitrage workers' wages; they arbitrage rates of return on financial instruments. Both non-financial and financial corporations involved in global competition value, above all else, the ability to unwind positions rapidly. For being liquid enables a firm to respond to changes in buying-selling and risk differentials, in time and across space. In the extreme, global investment is reduced to carry-trade plays. This set of strategies implies, of course, that some financial firms can earn substantial profits by selling contracts that provide some protection from the many forms of risk in this footloose world.

The asymmetric exposure of governments to unsecure income flows and to financial risks in this global environment is evident. Also at risk are the profits associated with production facilities located in any particular national space; shifts in the locus of market demand or in the global pattern of production-location incentives. These factors led governments to create and maintain supra-national compacts, as partial responses to these locationally-related risks. These compacts can lock in cross-border supply-demand relations by reducing tariffs and relaxing regulations. But they can also be used to attract more capital inflows.

The compacts that have been signed and activated in the neoliberal era represent efforts, then, to both capture economic rents in two ways – by holding some firms' activities in and by inducing other firms to cross into the signing nations' economic space. They can be defined as neoliberal mechanism designs, because they limit nations' capacities to freely manage macroeconomic policy, in favor of rules designed to attract the inflows of capital and finance acquiesce to the core prerogatives of the neoliberal era – the freedom of action of capital and finance.

The North American Free Trade Agreement (NAFTA) between the US, Mexico, and Canada famously provides incentives for firms selling goods in the US to locate portions of their production and assembly in Mexico and/or Canada. Environmental and worker-protection laws in the three participating nations were softened so as to facilitate harmonization. At the same time, financial investment and banking clauses forced financial equity-ownership and product markets to be more open, enhancing the bargaining power of large financial firms.

The most elaborate of the neoliberal mechanisms is the Eurozone. It requires its member governments to reinforce the integrity of the zone's supranational fiscal discipline: indeed, it establishes rules for inflation and for government debt. These rules are designed to send reassuring signals to mobile global capital and to facilitate Eurozone-wide trade-led growth. The Eurozone also encompasses a "two-tier" banking system, in which banks are regulated by the home nations in which they are registered, but are free to undertake activities that are authorized anywhere in the Eurozone. The idea is to use self-imposed limits on participating nations policies to create a zone which is more attractive for investors, and for sellers and producers of goods.

The vision of neoliberal mechanism designs, then, is of self-disciplining "handmaidens" of globally mobile market forces. These mechanisms provided a model that many regional areas elsewhere emulated. Included in the list of imitators were nations and regions that had been heavily affected by previous global crises. The Association of South-Eastern Asian Nations (ASEAN) combines elements that encourage free trade, as well as elements that deepen incentives for intra-ASEAN trade and production.

4. From global imbalance to financial exuberance to global crisis

So by the early 2000s, the three elements that currently shape global policy options – systemic global imbalances, empowered and largely unregulated global finance, and neoliberal mechism designed in response to neoliberal world conditions – were all in place. A series of events was set in motion that both created the global crisis and then molded the distinctively weak response to that crisis. There is not space here to describe these unfolding events in depth; instead we restrict our attention to some key points.[4]

In the 1990s, the rescue of the US mortgage market involved securitization and the vast expansion of secondary-market facilities for bundling and distributing this debt. This solution was consistent with the systematic inflow of funds into the US in those years via the "twin deficits." This development coincided with the emergence of unregulated financial funds, including hedge funds and private-equity funds; these new funds were seeking above-market returns. The possibility of above-market returns emerged as the market potential of lower-income, financially-excluded populations in the US became increasingly evident to the deregulating and consolidating intermediary sector. The list was extensive and diverse: racial minority communities unable to

[4] See Dymski (2009) for a more extended discussion of the root causes of the subprime crisis.

obtain housing finance, immigrants needing mechanisms for remittance transfers, working-class households that provided a source of demand for pay-day loans and debt cards, and so on. This intersection between return-hungry funds, consolidating lenders, and income-starved populations led to the emergence of numerous forms of predatory lending. A particular break-through was the creation of mechanisms – including secondary-market underwriting – for securitizing higher-risk loan paper.[5]

Subprime loans were originally used primarily for second mortgages and refinancing in minority communities. But as housing prices reached skyward in various regions of the US, subprime loans and a variety of innovative loan practices linked to these loans provided means for desperate, housing-hungry households to overcome the exploding housing-price/income gap. The housing-price situation became increasingly unstable, as megabanks and funds engaged in zero-sum games with derivatives based on subprime securities pushed these markets beyond the limits of available global liquidity. Finally a global margin call brought down the US housing market, the subprime lending market, and most megabanks in the US, along with many megabanks headquartered elsewhere.

In the next stage of these unfolding events, the center of global attention shifted to Europe. The US subprime crisis transmitted a virus to Europe's banks. Many Eurobanks took on large portfolios of collateralized debt obligations during the pre-crisis years: so when this paper proved to be riddled with fraud and non-payment problems, these banks' balance-sheet positions deteriorated. The ensuing recession, which hit especially hard in southern European countries, then adversely affected Eurozone nations' rates of economic growth. National efforts to offset catastrophic economic downturns through borrowing-fueled stimulus then forced weaker nations' banks to take on more debt of questionable value. Bond-market traders burned by the subprime crisis then drove down the price of these nations' debt, and consequently further undercut these banks' solvency. The rules of the European monetary union precluded significant fiscal stimulus. Eventually these banks' risks was shifted onto central banks in the Eurozone, and confronted the European Central Bank itself with a choice: it could force debt writed-downs that would provide relief to member governments but pushing banks to the wall; or it could stand by the banks and insist on painful – and possibly destabilizing - fiscal retrenchment in debt-heavy member countries.

Global constraints versus global solutions

As the global crisis grinds on, the combined impact of global imbalances and deregulated finance, together with the predominance of neoliberal mechanism designs as frameworks for crisis response is ever clearer: they are locking the global economy into a set of policy boxes whose

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[5] As discussed in Dymski (2009), the classification of subprime borrowers as high-risk is problematic; a large percentage of subprime loans were made to borrowers that should have qualified for prime loans. This misclassification represents the continuation of practices of racial discrimination that had been posing barriers for racial-minority communities since the creation of federally-supporting US housing finance in the 1930s.

inconsistent overall architecture adds up only to policy frustration, not problem resolution.

The problem at its most general – structural – level was identified by Wynne Godley at Cambridge University (UK), and then applied by Godley and several colleagues to the situation of the United States after Godley became a distinguished scholar at the Levy Economics Institute in the 1990s.[6] The analysis simply explores the implications of an aggregate demand-supply balance equation for the economy as a whole; specifically, if there are no changes in holdings of international reserves, then the following relationship must hold:

$$(I - S) + (G - T) + (X - M) = 0. \qquad (1)$$

Here, I = investment, S = savings, G = government expenditure, T = taxes, X = exports, and M = imports. If we note that (S - I) equals private-sector net savings, (G-T) equals the government deficit, and (M – X) equals the current account deficit), then this gives us:

(Government deficit) – (net domestic savings) = (current account deficit) (1a)

Equation (1a) must hold, as noted, if we abstract from cross-border shifts in reserve holdings. The logic applied by Godley and his colleagues was to point out that increases or decreases in gaps on one side of equation (1a) would require compensating increases or decreases elsewhere. So if net domestic savings are held constant, a growing government deficit can be financed by a growing current-account deficit – since the latter implies an offsetting inflow of foreign savings. This is precisely the situation of the US in the 1980s' "twin-deficits" period.

For any one country, problems of macroeconomic management can arise when shifts in one component of equation (1a) requires adjustments elsewhere that can be achieved only by unlikely parameter shifts or by reduced levels of national income. There are many different permutations, which Godley and his colleagues analyze in depth. The one that concerns us is this: a downward shift in the current account deficit, all things equal, would require a reduction in the government deficit; and both shifts could be orchestrated by a reduced level (or growth rate) of national income.

For the global economy considered as a whole, another dimension of adjustment arises, because current account deficits must (in principle) net out to zero across all countries. This brings us to the contemporary global situation, culminating with the current crisis. Figures 1-4 illustrate the trajectory of current-account imbalances for several key regions within the global economy from 2001 to the present. Here only selected aspects of the data shown are mentioned.

[6] See, for example, Godley and Izurieta (2001) and Godley, Papadimitriou, and Zazza (2008).

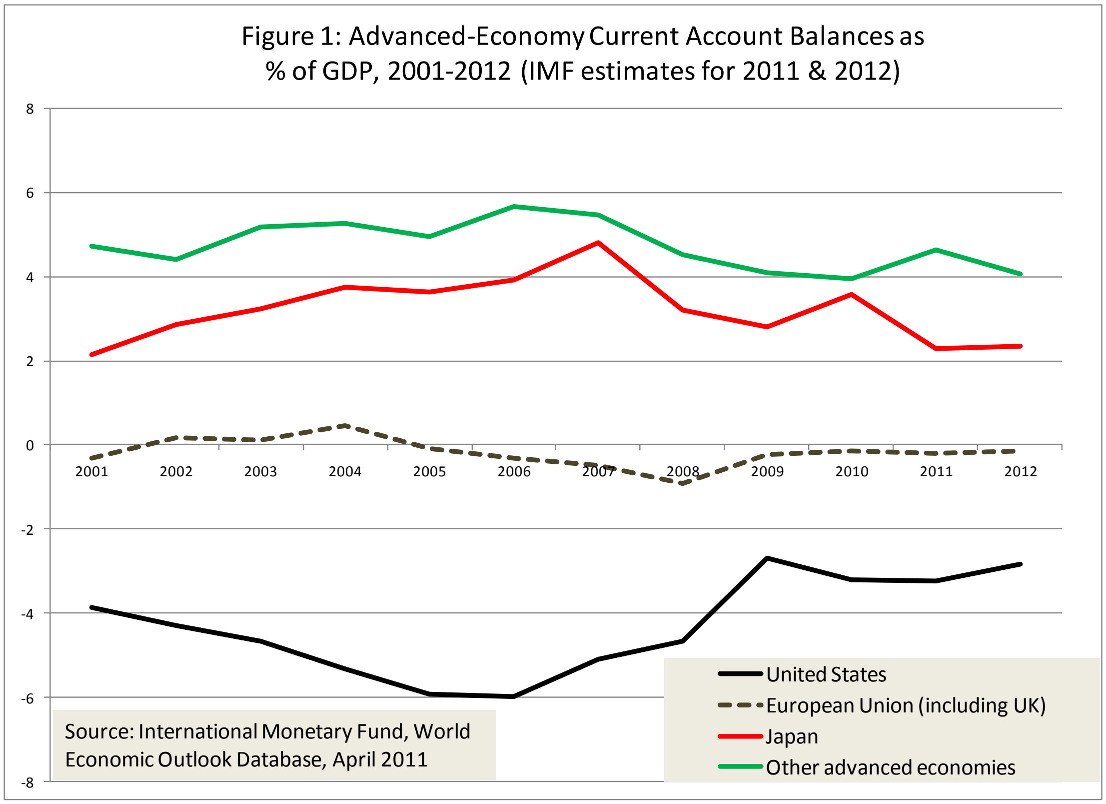
Figure 1: Advanced-Economy Current Account Balances as % of GDP, 2001-2012 (IMF estimates for 2011 & 2012)
8
6
4
2
0
-2
-4
-6
-8
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
United States
European Union (including UK)
Japan
Other advanced economies
Source: International Monetary Fund, World Economic Outlook Database, April 2011

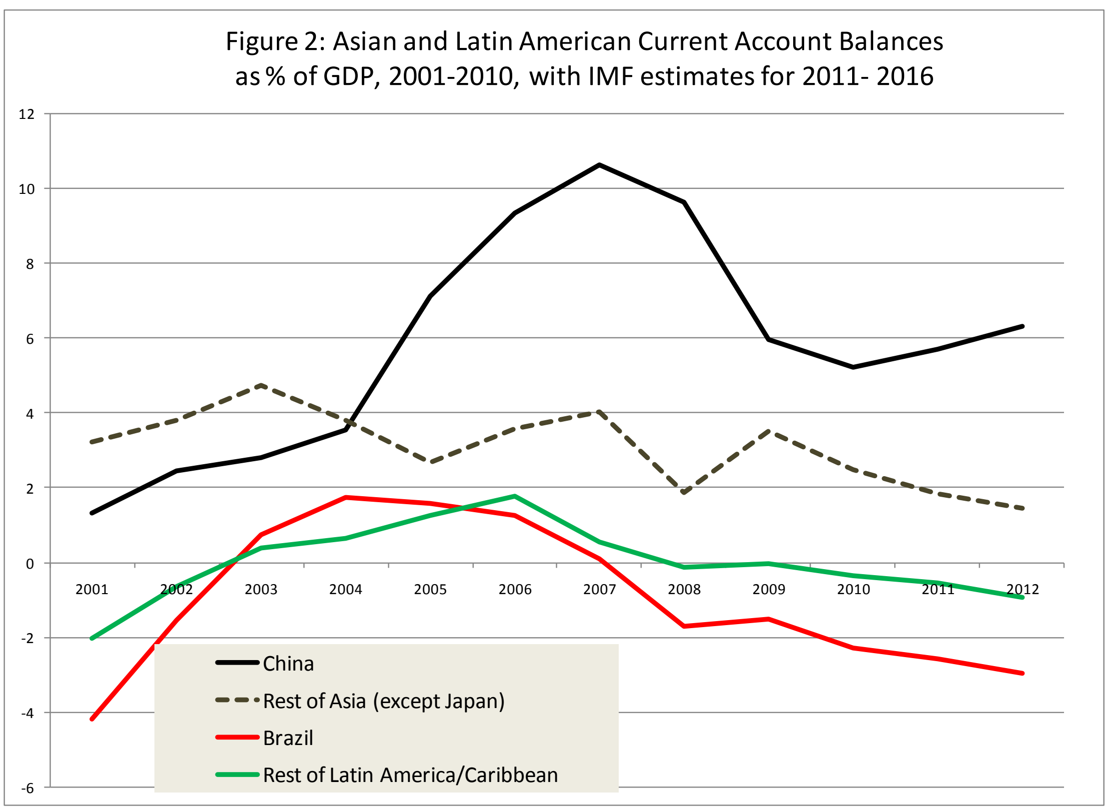
Figure 2: Asian and Latin American Current Account Balances as % of GDP, 2001-2010, with IMF estimates for 2011- 2016
12
10
8
6
4
2
0
-2
-4
-6
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
China
Rest of Asia (except Japan)
Brazil
Rest of Latin America/Caribbean

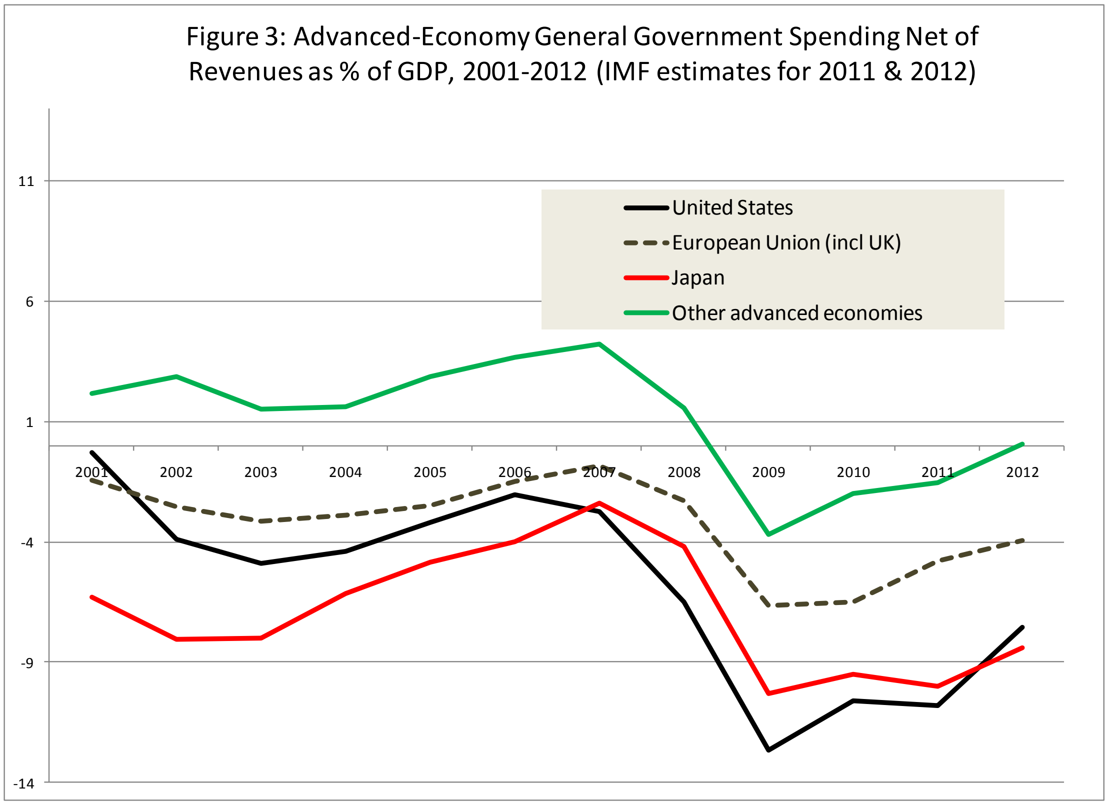
Figure 3: Advanced-Economy General Government Spending Net of Revenues as % of GDP, 2001-2012 (IMF estimates for 2011 & 2012)
11
6
1
-4
-9
-14
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
United States
European Union (incl UK)
Japan
Other advanced economies

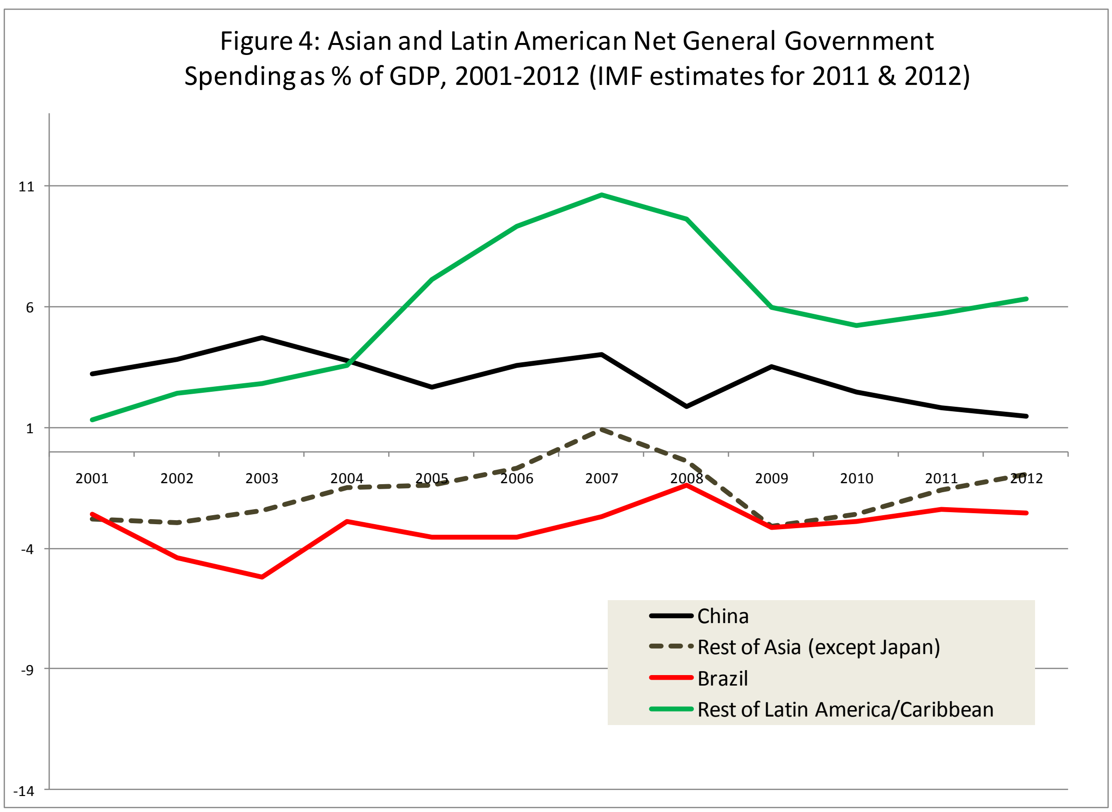
Figure 4: Asian and Latin American Net General Government Spending as % of GDP, 2001-2012 (IMF estimates for 2011 & 2012)
11
6
1
-4
-9
-14
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
China
Rest of Asia (except Japan)
Brazil
Rest of Latin America/Caribbean

Figure 1 shows the current-account situations of the advanced global economies, including the US, the European Union, and Japan. Note that prior to the 2008 crisis, Japan was systematically in surplus, the Eurozone approximately balanced, and the US in a deficit. Figure 2 shows the situation for the remaining Asian nations and for Latin America. The sizeable Chinese current-account surplus is shown, as is the large (albeit smaller) surplus for other Asian countries. The Latin American nations moved into surplus in the early 2000s, but then fell back into deficit with the 2008 crisis.

Figure 3, in turn, shows that Japan, the US, and the European Union nations all had government deficits, which worsened considerably with the onset of the 2008 crisis. Figure 4 demonstrates that China has had a steady government deficit in the 2008s, and Latin American nations outside of Brazil, an even larger relative balance. Brazil, by contrast, has been consistently in deficit, as have been the other nations in Asia apart from China and Japan.

Note that with the onset of the global crisis period in 2008, the current-account balance of the US improved somewhat, though it remained large relative to national income. That of the European Union, taken as a whole, also improved slightly, while current-account balances in China and in the rest of developing Asia and in Latin America deteriorated.

The global crisis is inducing adjustments on these balances for various reasons. Most of the European Union consists of member nations of the Eurozone. These nations' mandate under the Maastricht Treaty requires fiscal contraction as an adjustment mechanism, in response to the emergence of these crisis-generated increases in collective national deficits. the resolution of the crisis of the logic of neoliberal mechanism designs. The United States is also under political pressure to reduce its deficit; this in turn will require contractionary fiscal adjustments.[7] Both sets of adjustments will lead to improvements in current-account performance. Japan, in turn, faces less political pressure to reduce its government deficit; but it is now making major efforts to reduce the relative value of the yen so that its current-account balance does not slip further. Finally, China has been unwilling to see its current-account balance deteriorate; thus, it has managed the yuan so as to control its rise against other currencies.

These are all adjustments that will have the effect of putting downward pressure on the pace of global economic growth. Every nation's desire to either reduce its government deficit or to improve or defend its trade position will lead to reductions in growth rates. Every nation, in seeking to conform to compact rules or to achieve gains at the expense of other nations, contributes to undercutting the conditions for global prosperity.

The larger problem posed, then, by every nation's effort to improve its own global position – or to

[7] The US constitutes an interesting case, for it has adopted the logic of a neoliberal design mechanism through its political paralysis, symptomatized by the "Tea Party's" takeover of Republican Party political discourse and the disastrous "debt-ceiling" debate.

conform with the rules of the neoliberal mechanism design to which it belongs – is that global growth is being undercut. Any nation that moves in the opposite direction faces the problem that much of the impetus it creates will be siphoned off by the contractionary impulses of nations in the rest of the world. So large-scale fiscal stimulus – beyond what has been done in the first round of responses to the global crisis (in 2008-2010) – is unlikely. Other policy measures that have been proposed in response to crisis – such as bank recapitalization, tax increases on upper-income households, and so on – will have little effect against this larger context of fiscal contraction and efforts at growth-through-trade-surplus-gains.

Policing each nation's political logic is a global financial sector whose hopes for change are offset by its skepticism about whether change is thinkable. Unresolved, bitter, and confused debates about the way forward dot the public-intellectual and policy-maker landscape. Within a three-day span in September 2011, Martin Wolf argued (in part on the basis of an HSBC study) that the markets are "telling us" .. borrow and spend, please." Wolf is fully cognizant of the structural-imbalance analysis set out above; he goes on to observe, "Fiscal deficits are helpful, therefore, in a balance-sheet contraction, not because they return the economy swiftly to health, but because they promote the painfully slow healing." (Wolf 2011) But in a rejoinder a day later, HSBC economist Stephen King wrote,

> "Unfortunately, I was unable to detect the call to 'borrow and spend, please' so audible to Mr Wolf. I took a deep breath and immediately realised what was going on. I might not have been able to hear anything. But I could certainly smell something. I could smell fear. … low government yields cannot justify higher government borrowing" (King 2011)

US Treasury Secretary Tim Geithner, writing in the same issue of the *Financial Times* as King, opined that there are three keys to renewing global growth: the US must "strengthen growth and employment," Europe needs to take "more forceful action to generate confidence that it can and will resolve its crisis", and "China and other emerging economies need to continue to strengthen domestic demand and allow their exchange rates to adjust to market forces." (Geithner 2011).

The confusion here is evident. Martin Wolf advises that neoliberal mechanisms be disregarded for now, but this makes King fearful: Geithner doesn't quite say he agrees with Wolf, and instead calls for China "and other emerging nations" to take the lead in renewing non-neoliberal Keynesian stimulus programs. Any analysis of Brazil's exchange-rate situation would suggest, further, that either the US Treasury secretary does not regard Brazil as among the emerging economies that should follow a Keynesian path, or he is indifferent to the real overvaluation problem.

6. Challenges for new developmentalism: Brazil's dilemma and Global-North crisis

This brings us to the implications of this triple conjuncture – global imbalances, empowered finance, and neoliberal mechanism designs – for the new developmentalism. On the one hand, unchained finance – even in its weakened state – has retained its strategic advantage over nation-states in shaping the global economic landscape. Megabanks have lost substantially in the crisis: on banks' balance sheets, the large volumes of loan-loss declarations over the past four years have had a major impact; and the market value of financial firms' equity has also fallen directly. Table 1 shows that between 2004 and 2010, the market value of US megabanks among the top 1000 firms in global equity value fell by 44 percent. However, nation-states' leverage in global debt markets is seriously impaired. While it is true that the US and UK can borrow at very low rates of interest, this plausibly reflects their fear of risk-taking, as King (2011) put it. And borrowing rates have systematically spiked for every government whose fiscal soundness and commitment to austerity has been questioned: Greece, Portugal, Spain, and now Italy populate this list. In effect, finance retains the upper hand in this "Throne of Kings" game: whereas megabanks ruled until the 2008 subprime crisis, now fearful traders taking positions in bond markets do.

One implication of this situation is positive for the new developmentalism. Global-North nations are now too weak to block the renaissance of national development planning in global-South nations. The fate of development banking in Brazil provides a clear example of the shift that has occurred. Brazil's recent growth has been facilitated and partly orchestrated by the Brazilian National Bank for Economic and Social Development (BNDES). This national development bank, which now has an asset size larger than that of the IMF, grew forcefully via federal-government fiscal infusions and strong returns on its assets during the Lula Presidency. Similarly, Brazil's prosperity has been strengthened by Lula-Rousseff administration policies to increase the minimum wage, extend safety-net expenditures, and renew the national commitment to providing affordable housing finance for lower-income families.

But two other implications of the current situation of global-North economies are negative for the new developmentalism. The first and most obvious is fiscal slowdown in the global economy. Downward pressure on aggregate demand is at work in both the US and Europe. This will reduce demand for new-developmentalist states' exports. The only significant contrary impulse comes from China; but China is also slowing its growth rate, and in any event buys virtually no advanced-sector products from global-South economies. Second, however, the need of the US and Eurozone governments to reduce their government debts and/or to improve export performance means, in both cases, downward pressure on their relative exchange rates. Given China's global position, and that of several other East Asian nations, this leaves little or no room for "new entrants" in the "Export-your-way to growth" club. A review of trends shown in Figures 1 and 2 cements this point.

Brazil's exchange-rate overvaluation

This brings us to a key problem confronting the Brazilian economy: its overvalued exchange rate. While the exact amount of overvaluation is disputable, there is little doubt that the high real has been one source of economic trauma for Brazilian businesses. It compromises their ability to compete abroad in export markets, and also leaves the Brazilian home market wide open to market-entry by low-cost competitors, notably China and other Asian nations. As such, it presents substantial barriers for Brazil's development strategy. The danger is that while government and industry are working in tandem to build up selected areas of industrial strength, a high real may hollow out Brazilian industry in areas most exposed to import-competition.

So a logical economic-policy reaction is to defuse this situation by reducing the real value of the Brazilian real. In principle, this should reverse all three adverse trends: it might be expected to stop the erosion of Brazilian domestic industries' markets, permit export growth in areas other than natural resources and agriculture, and allow more space for Brazilian industrial development strategies. However, here is where the possible impacts of the global-North's great crisis come into play. The structural flow-imbalances that have characterized the world economy since the 1980s have only deepened with the 2008-11 crisis. More exports by Brazil, all things equal, worsen other nations' imbalances. But one very likely reaction by nation-states elsewhere in the world – in particular, by the global-North nations and China – will be strong efforts to reduce their flow-imbalances. This will squeeze the space for export expansion.

A second problem involves financial factors. Liberated finance in the global North has been doubly stymied by the coming of the Global Financial Crisis: on one hand, megabanks and funds had gotten used to mega-profits, and are seeking ways to restore their net cash-flows; on the other, there are few viable options for renewed profit-making in the current global context. One possible solution for sectoral cash-flow involves more profit-seeking in the global South; and within the global South, this must involve those nations that have sufficiently sophisticated and liberalized financial sectors that entry is possible. Here Brazil heads the list. Its economy's growth prospects are spurring entry by investment-banking and venture-capital firms from around the world; and many speculators are taking advantage of Brazil's high interest rates to take short-term profits through the carry trade.

This leads to a dilemma: Brazil's economy is ready to grow, in part by maturing and further developing its industrial sector. That sector's growth needs a lower real and a receptive environment for world trade. But the carry trade and Brazil's exciting investment prospects (one might write "exciting" investment prospects) are maintaining high global demand for the real, undercutting Brazilian industrial output and encouraging the hollowing-out of Brazilian industry. The fact that Brazil's overall growth rate depends in part on resource-intensive exports, for which a high real does not constitute an output barrier, factors into this problem. The dilemma then is that maintaining short-term growth in the current global conditions may come at the price of longer-term sustainability in industrial capacity and infrastructure and other investments.

7. Other paths for New Developmentalism in the denouement of the global crisis

What are the implications of this Brazilian dilemma for new-developmentalist thinking – and specifically, for Brazil's own economic strategy in the present conjuncture? In the longer run, there is no reason to think that new-developmentalism as it emerged through the Great Financial Crisis period represents an outmoded set of ideas. One possible scenario for global North nations' future is for their citizens to overthrow the shackles of neoliberal thinking, and to vote for imaginative governments willing to use Keynesian policies to put people back to work. Of course, other more draconian paths currently beckon in the global North, paths that would lead deeper into global depression and even to fascism. We do not speculate on these alternative futures or their probabilities of occurring here.

We instead turn to the need for short-term policy adjustments in global-North nations. And in this short-term, as we have shown, fiscal conservatism is ruling the day in the global North. What is needed, then, is an alternative immediate path that doesn't rely on exchange-rate reduction, since exchange-rate devaluation cannot be effectuated beyond narrow limits, and one hand, and will only marginally affect exports, on the other. It is also, however, crucial to cut any ties to "exchange rate populism:" pressures toward industrial hollowing out will increase if the real's rise continues.

Other strategies are feasible. One is to build supports for heightened real wage levels in Brazil (and elsewhere in Latin America) through an intensification of production in Brazil and elsewhere in Latin America, linked to the rise of a Latin American "mass consumption market." To facilitate this intensification, it will be necessary to renegotiate the terms of some South-South trade: Latin American deindustrialization/"hollowing out" cannot be the price paid to permit China to manage its growth problem.

A third strategy is to continue the shape and fund policies that will move favelas and other informal, lower-income settlement areas in or near Brazil's cities. These areas desperately need infrastructure expansion and renewal; and as they become part of the "cidade integra", challenges of land-use, landscape design, and planning abound. (Re)building favelas can be a national iniative in Brazil on the order of the national effort to end illiteracy. This redoubled effort in favelas and lower-income communities is especially important because the households that live in lower-income spaces are especially vulnerable to increased financial exploitation and fragility

This brings us to the fourth and final strategic point: care should be taken in permitting the expansion of financial-sector activities – and the presence of overseas funds seeking to leverage those activies - in Brazil. Brazil's prosperity has thus far survived the global meltdown better than most other global-South nations, in large part because of its key structural features – the significant presence in banking markets of publicly-owned, publically-accountable financial instititutions, Brazilian banks' modest use of off-balance sheet instruments, the high level of real-time information available to regulators, and so on. In the end, the solution to the global financial crisis is not the capital adequacy of the institutions supplying global finance, but the existence and maintenance of a socially-functional and economically-productive banking system. The fact that the reconstruction of finance in the wake of the current extended period of crisis must, in the end, be coordinated globally means that a Brazilian presence is needed in post-Basel-Accord global discusions about financial re-regulation.

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