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Home ► All Journals ► Politics & International Relations ► Review of International Political Economy ▶ List of Issues ▶ Volume 23, Issue 3 ▶ Developmental states and undervalued exc

Review of International Political Economy > Volume 23, 2016 - Issue 3

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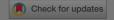
Original Articles

Developmental states and undervalued exchange rates in the developing world

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manufacturing sector's support for an undervalued exchange rate. These indings

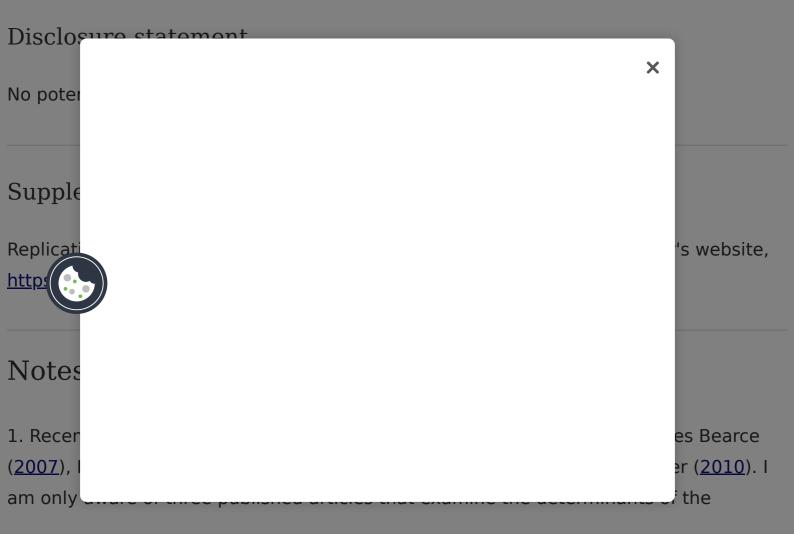
suggest that state institutions influence exchange rate policy, though their effects are contingent upon the configuration of interests in society.

KEYWORDS:

exchange rates	currency policy	export-led growth	state-owned banks	developmental state
interest groups				

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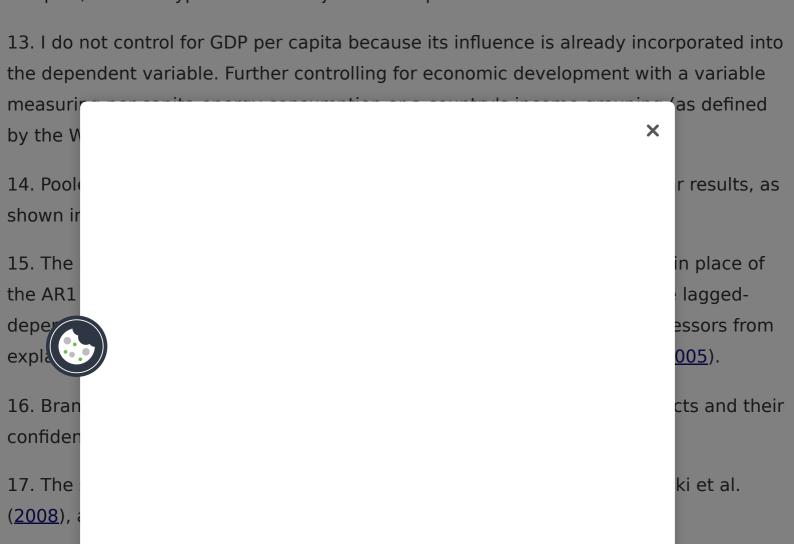


exchange rate level using cross-national data. Two of these articles (Copelovitch and Pevehouse, 2013; Steinberg and Malhotra, 2014) do not exclusively focus on this issue, but analyze both the exchange rate level and the exchange rate regime. The third study (Iversen and Soskice 2010) focuses on a different group of countries from the present paper: advanced industrialized nations, rather than developing ones. Steinberg's (2015) book contains cross-national statistical analyses of the political determinants of exchange rate levels in developing countries.

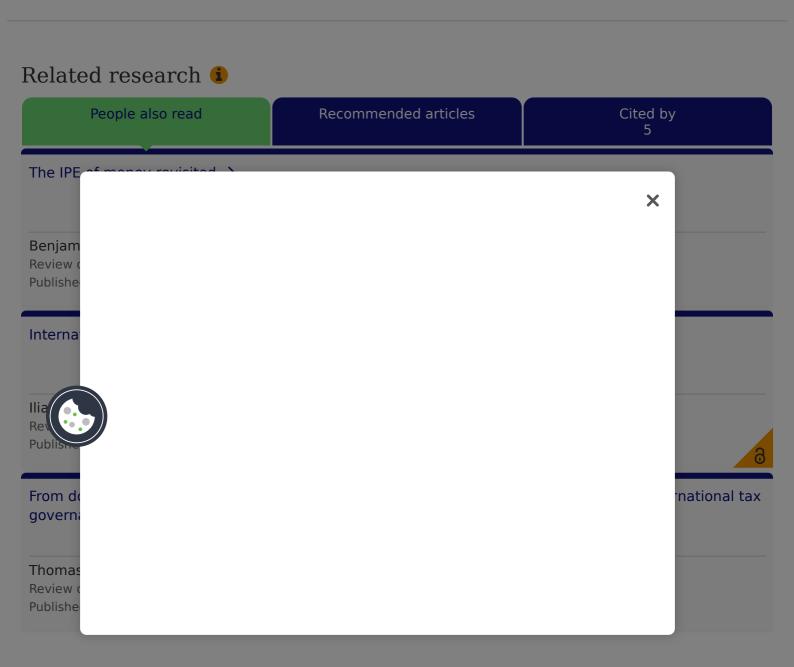
- 2. By comparison, it seems less likely that a meritocratic bureaucracy, another commonly cited attribute of a developmental state, would influence exchange rate policy.
- 3. By contrast, the short-run effects of undervaluation may not be positive. Devaluations often reduce output within their first year (Gupta et al. 2007).
- 4. Rodrik (2008) argues in favor of undervaluation on the grounds that it helps correct for market failures. For an example of the orthodox position, see Williamson (1990), which lists a 'competitive exchange rate' defined as a non-overvalued exchange rate as one of the ten elements of The Washington Consensus. According to Williamson (2009: 9), 'overvalued exchange rates are worse than undervalued rates, but a rate that is neither overvalued nor undervalued is better still.'



- 8. For a recent overview of this massive literature, see Burstein and Gopinath (2014).
- 9. In the World Bank Enterprise Survey (2002–2006), the average manufacturing firm imports 32% of all its inputs into production (n=44,999), finances 20% of its investments from local bank borrowing (n=26,839), and 15% of its debts are denominated in foreign currency (n=18,263).
- 10. Students and workers were the main constituencies of Ghana's government at the time. They supported overvaluation (Herbst, <u>1993</u>: 41–43).
- 11. There is one difference between my measure and Rodrik's: Rodrik constructs a measure of undervaluation; I invert his scale to create a measure of overvaluation.
- 12. Augmented Dickey-Fuller tests indicate that overvaluation is not likely to suffer from unit root problems. The null hypothesis that all panels have a unit root was overwhelmingly rejected (p < 0.001). To provide more conservative tests, I also ran separate tests for each developing region (Eastern Europe & Central Asia, Latin America, Middle East & North Africa, Sub-Saharan Africa). For each of these subsamples, the null hypothesis was rejected with p < 0.05.



- 18. Although useful as a robustness check, Dollar's measure has several weaknesses, including a small sample size, and the inclusion of some questionable variables (e.g., regional dummies) in the equation used to estimate the equilibrium real exchange rate.
- 19. These variables are taken from Ilzetzki et al. (2008).
- 20. I use Frankel and Rose's (1996) widely used definition of a currency crisis, which is a nominal exchange rate depreciation greater than 25% that is also a 10% or larger increase in the rate of depreciation. Using the percentage change in the nominal exchange rate instead produces similar results (see the appendix).
- 21. La Porta et al.'s (2002) data are not suitable for panel analyses because they are only available for two years, 1975 and 1995.
- 22. When using Micco et al.'s (2007) variable, the estimates are not statistically significant, though their magnitude is similar to the other models.



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