On Capital flows and interest payments and long-term economic growth: revisiting the balance-of payments constrained growth models

by Juan Carlos Moreno Brid *

(Paper prepared for the session on The role of effective demand in Keynesian models of growth of the Conference on Old and New Growth Theories: An Assessment, Pisa, 5-7 October, 2001)

Within the Keynesian tradition it is recognized that the analytical framework known as the balance-of-payments constrained growth model (BPC-model) introduced by Anthony Thirwall more than two decades ago, and further developed by him and N.Hussain, was a pathbreaking contribution to understand the role of demand on the long-term growth of economies open to international trade and finance. This framework, based on the simple assumption that trade deficits can not be indefinitely sustained, showed that an economy´s long-term rate of growth is essentially determined by the rate of growth of its exports and the income elasticity of its imports.

The model was recently extended by Moreno-Brid (*Journal of Post Keynesian Economics, 1999, Vol 21*) by introducing in it a different notion of long-term equilibrium defined in terms of a constant ratio of the trade deficit to national income. This extended version of the BPC-model ensured that external debt was not on an explosive track. However, notwithstanding its merits, this extended version of the BPC-model has the important limitation of assuming away the influence of interest payments of foreign debt. The paper we intend to present at the Conference corrects such limitation by revising such extended version of the BPC-model in order to explicitly capture the influence of interest payments on external debt. The paper also examines the stability conditions of this –thus extended- theoretical model under particular conditions regarding the dependence of domestic investment on imported machinery and equipment. An important theoretical contribution of this paper is to contrast the formulation of the fundamental constraints on long-term economic growth as identified by the BPC-model and the standard formulation of such constraints given by mainstream models as a function of the real rate of interest.

The paper has an applied section which tests the empirical adequacy of the extended BPC-model to the Mexican case. Through the use of modern econometric techniques the empirical analysis shows whether Mexico's long-term economic growth may be explained by the evolution of external demand for its exports, its long–term income elasticity of imports and the evolution of rate of interest on international capital markets.