

New steps in the construction of New Developmentalism

*Novos passos na construção do
Novo Desenvolvimentismo*

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RESUMO: Neste artigo eu proponho novos ou relativamente novos passos na construção do Novo Desenvolvimentismo: a existência de políticas de conta-corrente, a política de crescimento com déficit em conta-corrente, além dos equilíbrios corrente e industrial, o equilíbrio com déficit em conta-corrente, e a doença holandesa estendida. Os três equilíbrios são representados em um novo gráfico. Discute-se uma nova forma de neutralizar a doença holandesa por meio de tarifas de importação e subsídios à exportação de produtos manufaturados.

PALAVRAS-CHAVE: Taxa de câmbio; conta-corrente; equilíbrios; doença holandesa; tarifas.

ABSTRACT: In this paper I propose new or relatively new steps in the construction of New Developmentalism: the existence of current account policies, the policy of growth with current account deficit, besides the current and the industrial equilibriums, the equilibrium with current account deficit, and the extended Dutch disease. The three equilibriums are depicted in a new figure. A new form of neutralizing the Dutch disease using import tariffs and export subsidies on manufactured goods is discussed.

KEYWORDS: Exchange rate; current account; equilibriums; Dutch disease; tariffs.

JEL Classification: F31; E4.

Some time ago I wrote a report, “Steps in the construction of New Developmentalism”, in which I tried to define the moment when each step (model, concept, idea) in the attempt to build a new theory had been introduced.¹ I am writing this paper now because it contains some new steps in such construction: the existence

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¹ Bresser-Pereira (2023, last version).

of current-account policies, the policy of growth with current account deficit, the equilibrium with current account deficit, and the extended Dutch disease.

Conventional economics assumes that the exchange rate is simply determined by the market. The New Developmental Theory (NDT) or simply New Developmentalism agrees with the role of the market but adds that it also depends on the existence of the current account policy the country adopts, which, in the case of developing countries, is generally a deficit, not surplus policy. It follows from this fact in the NDT, in addition to the current equilibrium and the industrial equilibrium, we have the equilibrium with current account deficit. The current equilibrium is the most general, it is the one that intertemporally balances the current account. Industrial equilibrium exists in commodity-exporting countries suffering from Dutch disease. And the equilibrium with a current account deficit is a perverse “equilibrium”, which corresponds to the orthodox “fundamental equilibrium”.²

Contrary to popular belief, the exchange rate is manageable. Not fully, but under constraints. Essentially, the market constraint, but also political constraints. When I wrote my first paper on Dutch disease,³ I proposed a way to neutralize it: the adoption of a variable tax on commodity exports. But I am now persuaded that this alternative is politically unfeasible, and in this paper, I defend the adoption of a tariff reform that neutralizes the Dutch disease.

In the latter two paragraphs, I resumed what I will say in this paper. To make it easier to understand, I will use Brazil as an example. I estimate that the industrial equilibrium is around R\$ 5.10, the current equilibrium, R\$ 4.70, and the deficit equilibrium, R\$ 4.50 per dollar. Dutch disease, which is the difference between the first two equilibria, R\$0.40, and extended Dutch disease, which I will introduce in this paper, is the difference between the first and the third equilibrium, R\$0.60 per dollar. This allows me to expose more clearly and concretely the long-term growth problem of quasi-stagnated countries like Brazil, which incur recurrent current account deficits, which appreciates the national currency, and cease to neutralize the Dutch disease, thus leaving the manufacturing companies without a special exchange rate that makes competitive the capable ones.

EXCHANGE RATE AND GROWTH

There is no *theory* in the economic literature about the relationship between the exchange rate and the growth rate; just paper showing empirically its relevance and, in certain cases, indicating some transmission mechanisms. In economic development books, there is not a chapter, not even a section, on the exchange rate.

² Some may argue that the first and the third are not real equilibriums, but if we give this word a larger meaning, they are; the first equilibrium refers to the exchange rate that balances the manufacturing industry, the third, balances a desired or happily accepted current account deficit.

³ Bresser-Pereira (2008).

Many researchers already demonstrated this fact empirically, but I believe that the only theory that explains it is NDT. The other economic schools think of the exchange rate as a short-term variable, volatile but fluctuating around the current equilibrium. If these schools were right, the exchange rate would not interfere with companies' investment decisions and there would be no need of a theory.

The theory starts from (a) the thesis of Classic Structuralist Developmentalism that growth in countries on the periphery of capitalism depends on industrialization or productive sophistication; (b) from the new-developmental thesis that a competitive exchange rate is a condition for the transfer of labor to sectors with a higher added value per capita that require more education and pay better wages;⁴ and (c) from the empirical observation that there is a tendency in developing countries towards cyclical and chronic overvaluation of the exchange rate. If these three considerations are true, in countries that exhibit a long-term deficit or surplus, the exchange rate will be a determinant of investment and growth. In the case of a deficit, when a company evaluates an investment project, it will make its calculations and realize that the production will not be competitive and, therefore, will not invest.⁵

In the case of developing countries, where there is a tendency for a cyclical and chronic overvaluation of the exchange rate, the exchange rate is a determinant of the decision to invest and the growth that follows. A currency overvalued in the long term makes the companies, even the ones using the best technology in their sector, non-competitive. As a consequence, it will not have *access to the demand*. To invest the state of each country must provide the general conditions of capital accumulation. They are microeconomic or macroeconomic conditions. The micro conditions are education, health care, good institutions, investments in infrastructure, and a domestic financial system to finance investments. The macro condition is a sustained effective demand. These conditions are well known, and countries do what they can to meet them – the micro conditions with the support of the neoliberal orthodoxy, the demand one, not so much. Even if a country is being reasonably well served, investors may not be able to invest because a third condition may not be present: the access to demand. As the NDT assumes the existence of countries that have an overvalued exchange rate in the long run, companies that use the best technology will not carry out their investment projects because they just don't have access to the existing demand.

THE CRITIQUE OF CURRENT ACCOUNT DEFICITS

The second question is why, in many countries, we see this tendency to the cyclical and chronic overvaluation of the exchange rate. It is a relevant question

⁴ Item (b) is a justification of item (a), which is in Prebisch. An alternative justification is Kaldor's argument on the economies of scale. The first argument is more relevant for developing countries; the second, for rich countries that are in the technological frontier.

⁵ Bresser-Pereira (2012).

because the exchange rate is only overvalued in the long term if the country follows this tendency. There are several arguments explaining that.

The rejection of current account deficits is a central tenet of NDT. It holds this view, which contradicts what seems to be obvious – that capital-rich countries should transfer their resources to capital-poor countries, which should receive them and rejoice. This would be true if the exchange rate was absent, but it isn't. Developing countries believe that they can grow with foreign savings. That the capital that finance the current account deficit (the foreign savings) will add to the domestic savings and total investment will increase. In fact, foreign savings may also be used to finance consumption, and what the conventional economics mistakenly says is that it will do the opposite, finance investment. There is an inverse relationship between the current account deficit and the exchange rate. In other words (other variables remaining constant), the higher a country's current account deficit, the more appreciated its currency. For a logical reason: the exchange rate is the price that balances a country's current account; in case of deficit, the exchange rate will be more appreciated, and in case of surplus, more depreciated than the current equilibrium.

A second and simple reason is that when the country incurs a current account deficit, the resulting net capital flows will be necessarily positive, and this will appreciate the national currency.

There are some exceptions in which the current account deficits may be propitious for growth instead of harmful. In the US there was some time ago a discussion about that problem, and they finally calm down with the argument that the large revenues from the capitals abroad would compensate the deficit. But this is a false exception. The revenues are part of the current account, not of the capital account.

A real exception is already present in my 2006 paper with Paulo Gala, in which we argued that foreign savings don't add to domestic savings, but replace them, and that it is possible to calculate the rate of replacement of domestic for foreign savings, which depends on the marginal propensity to consume and the marginal propensity to invest. Such rate is small just when the country is already growing very fast (a "miracle"), and given high prospects of profit, the large capital inflows will not make the marginal propensity to consume increase and the marginal propensity to invest fall. Therefore, the rate of replacement of domestic for foreign savings will decrease and foreign savings will add instead of replacing domestic savings.⁶

CAPITAL FLOWS

In this analysis, I am assuming that the net capital inflows are equal to the current account deficit, but they can exceed or be less than this deficit. These movements will influence the exchange rate, and it is for that reason that the interest rate

⁶ Bresser-Pereira and Gala (2006).

is one of the classical determinants of the exchange rate. Many countries raise interest rates to attract more capital, and capital inflows can also result from rich countries becoming optimistic about the country and deciding to increase their investments. When this happens, the exchange rate begins to appreciate strongly, which can force the country that until then was not worried about overvaluation, to start worrying about the loss of competitiveness of its companies. The country can then increase its reserves by buying dollars to prevent the overvaluation from becoming even more serious. Another possibility is that the country loses the confidence of the international financial markets and investments and loans become lower than expected, so that the exchange rate does not appreciate again while the distrust lasts. The first and second cases occurred in Brazil.⁷

High deficits or surpluses can also result from a sudden improvement or worsening of the terms of trade. This occurs especially in commodity export policies and is one of the causes of Dutch disease.

In rich countries, the situation is different. Net capital inflows are generally small if not negative because these countries also invest or lend abroad. As for the current account, it may run a surplus due to a policy in this direction, such as the policy adopted by Germany. In the States, the current account has been heavily in deficit for a long time, but this is partially offset by net capital inflows, which are very large.

WHY CONTINUED CURRENT ACCOUNT DEFICITS?

How can a country have an appreciated exchange rate in the long term? Why doesn't the market bring it to current equilibrium, even if in a volatile way? For NDT, the direct explanation is that many countries adopt a growth with current account deficit policy. More generally, we have two current account policies (the surplus policy, which we see in Germany and East Asia, and the deficit policy) and a non-policy: letting the exchange rate float around the current equilibrium. In the economic literature, the concept of current account policy does not exist, but the only thing that can explain the long-term appreciation or depreciation shown by many countries is the existence of a current account policy. If no policy is adopted, the market would drive the exchange rate toward the current equilibrium. On the part of the countries, this policy is often not entirely conscious and always not admitted as policy. In any case, they result of a sum of previous policies that lead to the deficit, and are a practice that they understand favorable to them if there is no threat of a balance of payments crisis.

⁷ The first case took place in Brazil between 2004 and 2011: the nominal exchange rate, which was at R\$ 3.00 per dollar in August 2004, dropped to R\$ 1.56 in September 2011. The second case occurred between 2016 and 2022: the real, which was at R\$ 4.05 per dollar in January 2016, instead of falling, rose to R\$ 5.37 in July 2022. Since then, it has been falling. (Source: Ipeadata.)

The reason behind the adoption of the growth with current account deficit policy is both fiscal and exchange rate populism. To implement the policy, deficit countries increase their fiscal spending and incur irresponsible public deficits.⁸ This is fiscal populism; it makes everyone happy: the salaries of employees and workers and the income of large and small rentiers increase, and the government is re-elected. Concomitantly, we have exchange rate populism: the country allows the exchange rate to appreciate or maintains it appreciated (one way to do that is to incur fiscal populism), and we have again artificially high wages and rentiers' revenues, and the government is reelected if, before, a financial crisis does not break out.⁹

Another reason for current account deficits is the populist policy of using the exchange rate as an anchor to control inflation. In cases of hyperinflation, an exchange rate anchor supplemented by resources from abroad that guarantee the credibility of the anchor can be effective. This is what happened in Europe after the First World War. In general, however, this is a harmful policy, which can lead the country to a major crisis. If any economist rejects the use of state-owned companies' prices to control inflation, what about using the exchange rate, which is "the country's price", for this purpose?

A certain number of developmental economists reject the policy explanation and believe that current account deficits are "structural," they would be due to external constraints. In fact, in commodity-producing countries the *external constraint* stems from two perverse income elasticities: while the income elasticity of imports of manufactured goods is greater than one, in industrialized countries the income elasticity of imports of primary products is smaller than one. But the consequence of the external constraint is not the current account deficit, because the exchange rate exists to balance it. The cost lies in the fact that the country will have to import less than it would import if it didn't have the constraint, and the population's standard of living will fall – it will because the imports' final use is either consumption or investments, and the former are usually much greater. The alternative is that the country doesn't reduce imports and incur in current account deficit, but this is exchange rate populism. Instead of referring to standard of living, I may say that the cost lies in the fact that national labor and the respective production is kept depreciated, and that of other countries is valorized. Finally, in one case or the other, the cost is less growth than if the foreign constraint was not present.

In the case of developing countries, there is an exception: when the country is already growing strongly, the marginal propensity to invest has increased, the marginal propensity to consume has fallen, and the inflow of capital barely generates an appreciation of the exchange rate; foreign savings complement domestic savings instead of replacing them.

⁸ In the case of the surplus countries, they only can pursue the growth with current account surplus if the state is sufficiently capable and the government, legitimate, to make workers and rentiers to accept a short-term sacrifice with the perspective of higher employment, wages, and revenues.

⁹ This was what almost occurred in Brazil in the 1998 presidential elections.

The large oil exporters that have huge current account surpluses and use them relatively wisely – in education, health care, and infrastructure – may also represent an exception. They don't know what the Dutch disease is and adopt export taxes only for fiscal purposes at a rate that is insufficient to neutralize the disease, thus failing to develop their industry, but growth takes place. Given its high income per capita, I suppose that this is the case of Saudi Arabia.

THE EXTENDED DUTCH DISEASE

Besides the deficit policy, there is a second cause for the tendency towards overvaluation of the exchange rate for the manufacturing or sophisticated industry: the Dutch disease. In this case, only the exchange rate for the industry is appreciated, configuring a case of two equilibria. Dutch disease is a long-term overvaluation of the exchange rate that occurs in commodity-exporting countries. It is caused by the fact that the country has Ricardian rents and/or a boom in commodity prices, which allows it to profitably export commodities at an exchange rate that is substantially more appreciated (lower) than the necessary exchange rate to industrial companies that use the best technology export or to defend themselves against imports of similar goods.

NDT calls industrial equilibrium the exchange rate that makes industrial companies competitive in a situation of Dutch disease, while current equilibrium corresponds to the exchange rate that intertemporally balances the current account.¹⁰ The Dutch disease is equal to the difference between the industrial equilibrium and the current equilibrium, while the extended Dutch disease is the difference between the industrial equilibrium and the equilibrium with current account deficit.

The country needs to neutralize the Dutch disease in order to industrialize. If it does not do so and the country has not yet become productively sophisticated, it will not industrialize. If the country has already industrialized because it neutralized the Dutch disease for a certain time, but then stopped neutralizing it, deindustrialization will be inevitable. This happened, for example, with Latin American countries that until the 1980s, before neoliberalism became dominant, neutralized the Dutch disease intuitively or pragmatically. To do so, they used import tariffs and export subsidies on manufactured goods. It wasn't a deliberate, rational way of neutralizing. But developmental policymakers knew that in order to develop their countries needed to industrialize, and that tariffs were essential for that. That's why they pragmatically used tariffs, even after the industry was no longer an "infant" one.

In 1990, many countries opened their economy; in Brazil, with trade liberalization, tariffs on manufactured goods fell from 45% to 12% (dismantling the neutral-

¹⁰ Gilberto Tadeu Lima, who read a previous version, in his comments observed rightly that "given that firms are heterogeneous on several dimensions, the industrial equilibrium involves an average competitive exchange rate". See Lima and Porcile (2013).

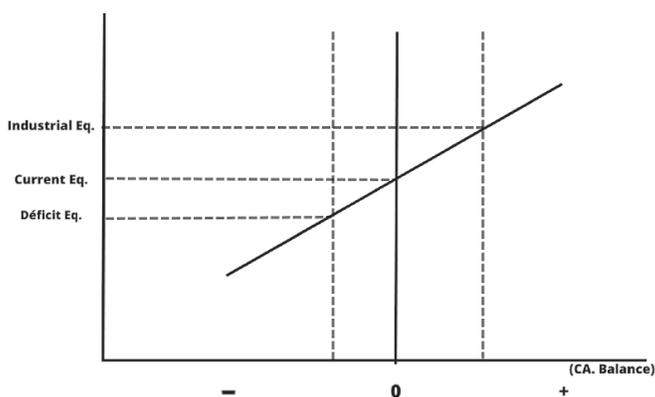
ization of the Dutch disease for the internal market) and subsidies were zeroed (destroying this neutralization for the export of manufactured goods). With the financial opening, interest rates could increase freely and caused an additional appreciation of the real. As a result of these reforms, the country entered a wave of deindustrialization; fell into the liberalization trap, as Eliane Araújo, Samuel Peres and I demonstrated in an empirically grounded paper, not into the middle-income trap.¹¹

I have always defined the Dutch disease as being equal to the difference between the industrial equilibrium and the current equilibrium. This makes sense because current equilibrium is the general equilibrium. But when the country has a growth with current account deficit policy and implements it, we have a more severe competitive disadvantage for the manufacturing industry. I propose to call it “expanded Dutch disease”.

THREE EQUILIBRIUMS

Summing up, other variables constant, the greater the current account deficit, the more appreciated (low) will be the exchange rate. And we have three equilibriums: the current or general equilibrium, which corresponds to a current account surplus, the industrial equilibrium in which the current account balances, and the equilibrium with current account deficit. They are in Figure 1, in which the current balance determines the exchange through a line that I choose to have a neutral inclination (45 degrees), but the inclination will vary depending on the country and the other variables that affect the exchange rate.

Figure 1



Using the example of Brazil, we can make the knowledge of these three equilibriums more practical. I estimate that in Brazil, today, (a) the industrial

¹¹ Bresser-Pereira, Araujo and Peres (2020).

equilibrium is R\$ 5.10 per dollar, satisfactory for the industry; (b) the current equilibrium is equal to R\$ 4.70 per dollar; it is the general equilibrium, and it should be the equilibrium towards which the exchange rate tends; (c) and the equilibrium with current account deficit is equal to R\$ 4.50, which is the equilibrium towards which the exchange rate tends given the current account deficit policy. In the first two cases, we assume that the net capital inflows are around zero, while in the third, they are positive.

The Dutch disease is equal to the difference between the first two equilibria, R\$ 0.40 per dollar, while the expanded Dutch disease is equal to the difference between the industrial equilibrium and the equilibrium with current account deficit, R\$ 0.70 per dollar.

TWO METHODS TO NEUTRALIZE THE DISEASE

So far, I have summarized a theory, which I believe is innovative, and which gives rise to policies. But what good would theories and policies about the exchange rate be if NDT shared the widespread belief of economists that this macroeconomic price cannot be managed? That the exchange rate is determined exclusively by the market? Undoubtedly, as with other macroeconomic prices, the exchange rate is a market price and therefore may not be fully controlled but is reasonably *manageable* by the state. When, for instance, the exchange rate follows a crawling peg regime (minidevaluations), this is a form of managing the exchange rate: keeping it constant in real terms.

The objective of this administration is to bring the exchange rate for the manufacturing industry to industrial equilibrium, and the exchange rate for commodities and other goods, to current equilibrium. Therefore, we have a dual exchange rate. The industrial equilibrium exchange rate guarantees a satisfactory profit rate for productively sophisticated goods, while the current equilibrium exchange rate guarantees the same for agribusiness and other sectors of the economy.

There are many relevant variables for determining the exchange rate – (a) the interest rate that attracts capital or not, (b) the international price of commodities or the terms of trade that increase or decrease the current account deficit, (c) the current account deficit or surplus policy, which determines net capital inflows or outflows, and (d) variations in productivity in the country compared to that of the main competitors given by the comparative index of the unitary cost of labor.¹² These four variables are always changing, but it is possible to have an exchange rate policy and successfully implement it.

In the case of oil exporters, the best alternative to neutralize the Dutch disease

¹² That is, by variations in the “value” of the foreign currency compared to the value of the national currency. On determining the exchange rate, see Bresser-Pereira, Oreiro and Marconi; Bresser-Pereira et al. (2022); Bresser-Pereira, 2024, chap. 10); Bresser-Pereira, Araújo and Feijó (*forthcoming*).

is a variable tax on the exports of commodities. Instead, in the case of countries exporting agricultural goods and meat, as it is the case of Brazil, a politically more viable alternative is to carry out a tariff reform on manufactured goods completed with a system of subsidies for their exports.

In both cases, the country must abandon its policy of current account deficit or growth with foreign savings and the current account will balance. If not, instead of having the simple Dutch disease we have the extended one, which will be more costly to neutralize. Also, in both cases, the reform (the introduction of the tax is also a reform) will benefit the manufacturing industry, but will have a cost: inflation will increase, although modestly, and the acquisitive power of the population will, in the short term, fall.

Given that the country discarded the growth with current account deficit policy and the current account balanced, now, with the neutralization of the Dutch disease, a surplus will emerge, and the country will be transferring savings to the rest of the world. But the manufacturing industry will grow and the whole economy will grow as, for instance, have happened in the Chinese long miracle (1982-2021).

The neutralization takes place in two stages. To put the exchange rate in current equilibrium it, is necessary to *abandon* the policy of growth current account deficit. This involves short-term reduction of current public spending and taxing luxury consumption. This policy would allow the economy to balance its current account. The second stage is to move the exchange rate to the industrial equilibrium.

THE TARIFF REFORM

To shift the exchange rate from current equilibrium to industrial equilibrium we have two possibilities. The original idea was a variable tax on commodity exports. This was the first proposal I made back in 2008, but it proved to be unviable from a political point of view in a country with a huge number of commodity producers who do not accept the tax even if it keeps their profit rate at a satisfactory level and more stable.

The alternative is to work with two equilibriums: the current equilibrium for all goods and services, except the manufactured or sophisticated goods to which the industrial equilibrium would apply, so as the Dutch disease is neutralized. To do that the government must promote a *tariff reform*. The reform will define two regime – the policy regime and the neutralization of the Dutch disease regime – and two corresponding tariffs: the *policy tariff* and the *neutralization of the Dutch disease tariff*. The policy tariff will correspond to the already existing tariff, which should be reduced. The neutralization of the Dutch disease tariff will be a *single* tariff for all industrial or sophisticated goods and it will vary according to the aver-

age price of commodities exported by Brazil.¹³ The law establishing the reform should define a few ranges of average commodity prices in real terms and the corresponding tariff: when the average price of the exported commodities is “low”, the single tariff will be zero; there will be a corresponding tariff for each price range above this level.

CONCLUSION

The short-term costs involved in following these two stages is not trivial: stopping incurring in current account deficits and neutralizing the Dutch disease, thus realizing a small surplus. In authoritarian administrations the political leader may try to use force, but he or she will not have the required political support even among its direct associates and will likely fail. In democracies the option for economic development is also not easy. And only can be achieved if the leader is legitimate politically, has republican spirit, and some lucky.

While the first alternative transfers the value of the tax on exports to the state, which thus captures the exceptional gains arising from the increase in commodity prices above the basic level, the second makes the same transfer but only relative to the manufactured goods. In the first alternative, the prices of all tradable goods and services will increase, in the second, only the prices of the manufactured goods. In both alternatives, the industry will no longer face the competitive disadvantage represented by the Dutch disease.

This is the policy that will neutralize the Dutch disease for the internal market. It will make competent companies located in Brazil (national or multinational) competitive internally. For them to be competitive to export, it will be necessary to create a subsidy, also variable, which will follow the same rules as the tariffs. Brazil, from 1969 to 1990, used export subsidies for manufacturers to neutralize the Dutch disease – the so-called export credit premium – whose success in transforming the country into a major exporter of manufactures was immense.

The theory behind the tariffs and subsidies I am proposing is relatively new,¹⁴ but its practice is far from being new. It has already been adopted by many countries, including Brazil and the United States. Although the industry was no longer infant, development *policymakers*, knowing that if tariffs were lowered, industrial companies would cease to be competitive and the country’s industrialization would be interrupted, kept them at a high level. The only country that subsidized exports of manufactured goods that I know is Brazil.

¹³ It may alternatively be due to variations in the terms of trade.

¹⁴ I presented it originally in Bresser-Pereira (2020), but few read it and there was no debate on the proposal.

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¹⁵ There is an earlier version in English, but the Portuguese version better addresses the problem of determining the exchange rate.