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Class Coalition and the Political Economy of New Developmentalism: an essay in honour of Bresser-Pereira

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Class Coalition and the Political Economy of New Developmentalism: an essay in honour of Bresser-Pereira[f].

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Abstract: This paper aims to show that the political obstacles to the implementation of a new-developmentalist model in Brazil can be overcome by the reconstruction of a developmentalist class coalition like the one that emerged in Brazil after the 1930 Revolution led by Getúlio Vargas. The concept of class coalition was developed by Bresser-Pereira in his book "The Political Construction of Brazil". A class coalition is defined as the emergence of coalitions of interests between groups that belong to distinct social classes. A *developmentalist coalition* results from the perception on the part of urban workers, industrial entrepreneurs and government technocracy that their economic interests are not served by liberal policies, since they are incapable of generating economic development, being useful only to rentiers and the domestic and international financial interests.

Keywords: New-Developmentalism, Class Coalition, Bresser-Pereira.

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1. Introduction

> "The history of all hitherto existing society† is the history of class struggles. Freeman and slave, patrician and plebeian, lord and serf, guild-master‡ and journeyman, in a word, oppressor and oppressed, stood in constant opposition to one another, carried on an uninterrupted, now hidden, now open fight, a fight that each time ended, either in a revolutionary reconstitution of society at large, or in the common ruin of the contending classes" (Marx; K; Engels. 1848. *The Manifesto of Communist Party*).

> "[W]e must first of all recall a principle that has always been taught by the Church: the principle of the priority of labour over capital. The principle directly concerns the process of production: in this process labour is always a primary efficient cause, while capital, the whole collection of means of production, remains a mere instrument or instrumental cause. This principle is an evident truth that emerges from the whole of man's historical experience" (Pope John Paul II).

The Brazilian New Developmentalist school[1], also known as the *São Paulo Consensus*,[2] can be understood as an approach to the *deep determinants*[3] of economic development in which *macroeconomic policy* is seen as the *causal cause* of long-term growth differentials between countries, notably middle-income countries.

The basic theoretical propositions of the Brazilian new-developmentalist school are as follows (Oreiro, 2018):

[1] The main exponents of this school are Luiz Carlos Bresser-Pereira (FGV-SP), José Luis Oreiro (UnB), Paulo Gala (FGV-SP) and Nelson Marconi (FGV-SP). Other important exponents of this school are André Nassif (UFF), Carmem Feijó (UFF), Eliane Araújo (UEM), Lauro Mattei (UFSC) and Luiz Fernando de Paula (UERJ).

[2] See Bresser-Pereira (2009) and Bresser-Pereira, Oreiro and Marconi (2016).

[3] Modern economic growth theory makes a distinction between the *proximate* determinants and the *fundamental* or *ultimate* determinants of the process of economic development (Maddison, 1988). Proximate causes are those most immediately responsible for the object under analysis; while the ultimate causes, more distant in time, are the basal causes, that is, the determinants of the background or origin of a given phenomenon[3]. In the context of the theory of economic growth, the proximate causes are those directly related to the level of per capita income, namely: the existing amount of physical and human capital, the availability of natural resources, the efficiency in the use of existing productive resources, and the level of technical and scientific knowledge existing at a given point in time. The ultimate or fundamental determinants, in turn, refer to the reasons why countries differ from each other about the availability of the factors that determine the level of per capita income. Among the ultimate determinants, we can list geography, institutions, income distribution, and economic policy regimes (Ros, 2013, p.15-17).

1 – The manufacturing industry is the long-term *growth engine* of capitalist economies, notably developing economies, which is understood as the *catching-up* with respect to high income countries.

2 – The dynamics of the manufacturing industry depends both on its price competitiveness (largely influenced by the real exchange rate) and on its extra-price competitiveness (technological sophistication, measured by the distance from the technological frontier)[4].

3- The overvaluation of the exchange rate (resulting from the Dutch disease and/or the inflow of foreign financial capital) generates early deindustrialization and replacement of domestic savings by foreign savings. Thus, the countries affected by this problem will present mediocre economic growth in the medium and long term, as well as a "chronic shortage" of domestic savings and structural deficits in the balance of payments.

4- The elimination of the exchange rate overvaluation requires a temporary reduction in the real wage. The acceleration of the pace of growth in labour productivity resulting from the change in the structure of production and employment induced by the devaluation of the real exchange rate will allow for faster growth in real wages in the future; so that salary losses will be recovered after a few years.

The Brazilian new-developmentalist school credits the low growth of the Brazilian economy in the last 30 years to the *regression in the productive structure*, that is, to an increase in the share of less dynamic sectors with less technological intensity in the value added generated in the Brazilian economy, and the behaviour of two macroeconomic variables contributed decisively to this picture: the chronic overvaluation of the exchange rate (momentarily interrupted by the cycles of exchange crisis and strong depreciation of the exchange rate) and the constant practice of high interest rates, even when the macroeconomic scenario was favourable, such as between 2005 and 2008. This process was expressed in deindustrialization and the re-primarization of the export agenda (Oreiro, 2016, chapter 8; Oreiro and Paula, 2021).

For the exponents of new developmentalism, the resumption of growth in the Brazilian economy involves a devaluation of the real exchange rate sufficient to make

[4] See Gabriel, Jayme Jr and Oreiro (2016).

Brazilian companies producing manufactured goods competitive in relation to their foreign competitors, which would induce a *process of increasing productive sophistication*, made possible by a significant increase in the investment rate. This is because an exchange rate at the level of the so-called *industrial equilibrium* – that is, the level of the exchange rate that allows domestic companies that operate with state-of-the-art technology to be competitive in the international market – would make it possible to equate the average costs practiced by domestic companies to those of their competitors. This allows not only the increase in the profit margins of companies operating in the sector that produces tradable goods (thus allowing an increase in the self-financing capacity of the investment of these companies); as well as inducing a *process of substitution of imports by domestic production.*

In this context, Brazilian industrial companies could regain access to domestic demand, lost in the last 20 years due to exchange rate overvaluation. Unlike companies that produce primary goods and have a higher profit margin, because they enjoy comparative cost advantages in their production and, in the recent past, higher prices in the international market; Manufacturing companies are faced with a different picture – narrower profit margins and, therefore, are more affected by exchange rate fluctuations, making exchange rate management important for the stability of their profit margins.

The implementation of this model involves a significant increase in the investment rate, which should be around 25% of GDP[5] to enable an accelerated pace of growth in per capita income, which represents an increase of about seven percentage points of GDP compared to the average of the last 15 years.

For this increase in investment effort not to be accompanied by an increase in external fragility, it is necessary that there be a significant increase in domestic savings, thus replacing external savings. This increase in domestic savings should come from the growth of corporate profits. In addition, *the neutralization of the Dutch disease*, endemic in countries with an abundance of natural resources such as Brazil, requires the country to operate with a current account surplus so that the undesirable regression in the

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[5] This number can be reached through the Harrod-Domar growth model. Considering a capital-output ratio equal to 3 and a capital depreciation rate equal to 3.5% p.a.; an investment rate of 25% of GDP is compatible with a growth rate of 4.8% p.a. for the gross domestic product. As the Brazilian population currently grows at a rate of 0.8% per year; it follows that the GDP per capita would present a growth rate of 4% p.a.; which would allow the per-capita income to double every 17.5 years. Regarding the figures for the capital-output ratio and for the depreciation rate of the capital stock, see Bonelli and Bacha (2013).

productive structure does not occur[6]. Thus, the implementation of the new-developmentalist model requires domestic savings higher than investment, of approximately 27% of GDP, 10 p.p. more than the average of the last 20 years.

How to make an increase of this magnitude in domestic savings possible? On a purely theoretical level, the devaluation of the exchange rate itself will be responsible for replacing foreign savings with domestic savings (Bresser, Oreiro and Marconi, 2016).[7] This is because the devaluation of the real exchange rate gives rise to an (a) increase (reduction) in the share of profits (wages) in income, as it generates an *instantaneous reduction of the real wage*, given that a significant part of the goods consumed by workers is made up of *tradable's*. As the propensity to save from profits tends to be greater than the propensity to save from wages (Kaldor, 1966); It follows that domestic savings tend to increase because of the devaluation of the real exchange rate.

From this reasoning it follows that the share of profits in income must have a positive correlation with the domestic savings rate. This conjecture is confirmed based on a sample of 31 developing countries for the period 1988-1992, as shown by Ros (2001).

In this way, we can see that the implementation of an economic policy regime based on the ideas of the new developmentalist school involves a clear problem of *political economy*, namely: how to convince workers to support a macroeconomic policy regime that will result, if successful, in a reduction in real wages and the share of wages in income? But this is not the only problem of this nature. The neutralization of the Dutch disease, necessary to obtain a competitive exchange rate, requires, among other measures, the adoption of an *export tax on commodities*. Given the economic and social importance of agribusiness in Brazil, political opposition to this type of measure can be considerable, to the point of making its implementation unfeasible.

This article aims to show that the obstacles of a political nature to the implementation of a new-developmentalist model can be overcome by the reconstruction of a developmentalist class coalition such as the one that emerged in Brazil after the 1930 Revolution. The concept of class coalition was developed by Bresser-Pereira in his book "The Political Construction of Brazil". A class coalition is defined as the emergence of coalitions of interests between groups that belong to different social classes (Oreiro,

[6] This argument is found in chapter 6 of Bresser, Oreiro and Marconi (2016).

[7] For recent empirical evidence regarding the replacement of foreign savings by domestic savings (and vice versa) see Rocha and Marconi (2013).

2015). A *developmentalist coalition* results from the perception on the part of urban workers, productive entrepreneurs and state technocracy that their economic interests are not served by liberal policies, since they are incapable of generating economic development, being useful only to rentiers and the domestic and international financial interests. Premature deindustrialization and the reprimarization of the export agenda caused by the overvalued exchange rate reduce the pace of economic growth and the quality of the employment structure in the country, thus contributing to the reduction of profits, wages and tax collection, which ends up generating a *structural fiscal imbalance in the public sector.*

Rentiers, on the other hand, are largely benefited by the exchange rate overvaluation. Dutch disease is the result of the existence of Ricardian rents associated with the exploitation of natural resources. In this way, landowners benefit from this situation because the extraction of Ricardian rents leads to an increasing appreciation of land. This process encourages the felling of forests with a view to using the lands previously occupied by forests for agribusiness or mineral exploration, which accelerates the greenhouse effect derived from CO2 emissions into the atmosphere. Environmental devastation is the little-known side of the Dutch disease (Guarini and Oreiro, 2022).

The maintenance of high interest rates in relation to the levels practiced in the rest of the world to attract foreign savings to *finance* domestic investment directly benefits rentiers since it generates a redistribution of income from the whole society to the owners of public debt securities, whether they are residents or non-residents in the country. This redistribution of income is, however, financed through the increase of the public debt, since the expenditure on the financial burden of the debt derived from the application of a high interest rate exceeds, by a large margin, the magnitude of the primary surplus that is politically and socially possible to be generated in an economy that has low dynamism. The result is a fiscal imbalance of a structural nature, which weakens the State, making it unable to carry out the investment and social expenditures necessary for Economic Development.

That said, this article is structured as follows. The second section presents the genesis of the concept of class coalition in Bresser-Pereira's work "The Political Construction of Brazil" and how this concept can be used to analyse the process of economic development in Brazil since 1930. The third section is dedicated to the analysis of the relationship between exchange rate and wages, seeking to argue that the policy of

competitive exchange rate does not imply a permanent reduction in real wages; but that the overvalued exchange rate, by inducing premature deindustrialization, will reduce the quality of the employment structure, resulting in a lower average level of real wages in the long run. The fourth section is dedicated to the political feasibility of neutralizing the Dutch disease through an export tax. In this sense, we will argue that the challenges imposed by the transition to a low-carbon economy may justify the adoption of measures that limit the growth of activities related to the production and exploitation of natural resources. Thus, the export tax can, for example, discourage the expansion of soybeans and beef production to areas covered by the Amazon rainforest due to higher logistics costs associated with greater distance from the centres of processing, distribution and consumption of these goods. Given that Brazil is a relevant producer of soybeans and beef on the international market, the withdrawal of the least efficient producers will result in a contraction of the world supply of these products, thus increasing their price on the international market. In this way, the most efficient producers, located outside the legal Amazon region, will not have a permanent loss of income. The fifth section is dedicated to the analysis of the problem of interest rates in Brazil, arguing that high interest rates are not the consequence, but the cause of the fiscal imbalance in Brazil. Lower interest rates, consistent with those prevailing in the rest of the world, can be obtained through structural reforms, such as monetary reform, which increase the effectiveness of monetary policy in controlling the inflation rate. In conclusion, we will show how all the elements presented in this article allow for an optimistic view of the possibility of re-enacting a developmentalist class coalition in Brazil.

2. **The Class Coalition in the work of Bresser-Pereira**[8].

In the *Communist Manifesto* published in 1848, Marx and Engels stated that the history of all societies has been the history of class struggle. Bresser-Pereira, in his book "The Political Construction of Brazil", offers another perspective for the history of societies. Without denying the existence or importance of the class struggle, Bresser states that history fundamentally reflects the occurrence of coalitions of interests between social classes, which are not seen as monolithic entities, but have large subdivisions. It is

[8] This section is largely based on Oreiro (2016).

precisely these subdivisions that allow the emergence of coalitions of interests between groups that belong to different social classes. In this context, the fundamental dialectic of capitalism does not consist in the conflict between capital and labour, but in the dispute between two alternative forms of economic and social organization of capitalism, namely: developmentalism and economic liberalism.

Developmentalism is defined, by Bresser, as "capitalism in which the role of the market in economic coordination is recognized, but (where) it is affirmed that the more general coordination of society and the market itself is the responsibility of the State; it is capitalism that sees markets as marvellous institutions of economic coordination, and therefore rejects statism, but it is also capitalism in which effective intervention in markets continues to take place to regulate them, correct their flaws, and promote socially agreed political goals; it is the ideology of moderate but effective state intervention, of moderate economic nationalism that does not exclude international cooperation; it is the national development strategy that will guide a people in the pursuit of its objectives" (op.cit, p.135).

In this context, "while in developmentalism, a coalition of businessmen, public bureaucrats, progressive intellectuals and workers defend for the State a coordinating role of the economic system alongside the market, in economic liberalism, rentier capitalists and financiers affirm that it is enough for the State to guarantee property and contracts, and keep its accounts balanced, because the rest the market would coordinate in an optimal way" (Ibid, pp.134-135).

It was these class coalitions that allowed the emergence of nation-states and the advent of capitalism and the industrial revolution, which were the historical preconditions for economic development. This is defined as "the process of capital accumulation with the incorporation of technical progress, which results in structural transformations of the economy and society and in the increase of consumption patterns of a nation-state" (Ibid, p.103).

The national revolution is, in this context, a precondition for economic development. It is from the constitution of Nation States that "peoples, generally endowed with a reasonable ethnic and, above all, cultural identity [are transformed] into nations" (p.305). These, by competing in the market or in the international political arena, began

to *promote* their development. This is therefore not the result of the free functioning of the market, but the product of a deliberate strategy on the part of the nation states.

Historically, the national revolution required the emergence of a class coalition between the industrial bourgeoisie and the public bureaucracy with the aim of replacing some oligarchy of an aristocratic character in the political control of society. In the Brazilian case, the national revolution, which took place in the 1930s with Getúlio Vargas government, involved the emergence of a coalition between industrial entrepreneurs, the state bureaucracy and the workers. The "National Popular Pact" was then formed, which would remain in force until the beginning of the 1960s. This implicit social pact allowed the emergence and subsequent hegemony of "national-developmentalism", understood as a national development strategy in which industrialization through import substitution was seen as Brazil's way of freeing itself from the semi-colonial condition that had been in place since the Proclamation of Independence in 1822.

Brazilian industrialization faced economic, political, and ideological obstacles. In the economic field, the great restriction was the abundance of natural resources, which allowed the production and export of coffee on a large scale. The Ricardian rents obtained from the cultivation of coffee generated a chronic tendency to *overvalue the exchange rate in relation to the level of industrial equilibrium,* that is, with respect to the level of the exchange rate that allowed industrial companies, which operated with technology in the state of the world of the art, to be able to compete with their counterparts abroad. Thus, we have the occurrence of *negative spillover effects* – a negative externality – from the primary exporting sector to the manufacturing sector, thus configuring the existence of a *market failure*. This market failure is now known as *Dutch disease*. In the political field, the coffee oligarchy was against industrialization because it intuited that it would require the adoption of some kind of tax on the export of agricultural goods, which in practice implied a redistribution of income from agricultural activities to industry. Finally, in the ideological field, industrialization was seen by liberal economists as an affront to the theory of comparative advantages, which stated that Brazil should specialize in the production of primary goods, given that Brazil's “natural vocation" would be agriculture.

These problems could only be overcome with the class coalition of the "People's National Pact", which made possible the introduction of a system of *multiple exchange rates*, which allowed the neutralization of the Dutch disease and the continuity of the industrialization process of the Brazilian economy. The system of multiple exchange rates

allowed the neutralization of the Dutch disease, because "the government passed on to the exporters of primary goods an artificially lower exchange rate. It was, therefore, a disguised tax on commodity exports that, by shifting the supply curve of these commodities to the left in relation to the exchange rate (not in relation to the international price of the commodity, here assumed to be constant), neutralized the Dutch disease, because this shift caused the exchange rate to depreciate in the value of the tax" (Ibid, p.164, n.2).

In the 1960s, this class coalition broke down as the industrial bourgeoisie, afraid of communism, began to support a military coup to overthrow President João Goulart. This rupture is also facilitated by the *exhaustion of the import substitution model*, on which the industrialization strategy of the Brazilian economy had been based until then. In fact, the import coefficient had been reduced from 28% of GDP in 1930 to just over 6% of GDP in the early 1960s. Since economic growth is essentially a *demand-led* process, that is, driven by the growth of autonomous demand, it would no longer be possible to stimulate growth by reducing the coefficient of imports, the solution would be to move to an *export-led* growth model, that is, an export promotion model.

In the words of Bresser-Pereira:

> “In 1966 the country had reached the limit of an industrial autarchy project. It could no longer base its industrialization on a strategy aimed at the domestic market, which would necessarily imply a decrease in the coefficient of imports of the Brazilian economy. Insisting on the strategy would cause losses of economies of scale and low productivity that would not be economically sustainable. Brazilian economic development had come to depend on the export of manufactured goods” [Translated to English by the author] (ibid, p.213)

After the 1964 coup, a new class coalition was formed, which encompassed the bourgeoisie, the state techno-bureaucracy and the multinational companies. The workers and sectors of the left were excluded. This political coalition allowed the continuity of developmentalism in Brazil with the adoption, from 1967 onwards, of a strategy of export promotion, made possible by the introduction of a subsidy for exports of manufactured goods. As a result of this strategy, the share of manufactured products in the Brazilian export basket went from about 10% in 1964 to 30% in the early 1970s. This new industrialization strategy allowed the Brazilian economy to grow at an average annual

rate of 11.3% in the period 1968-1973. In the same period, industrial production expanded at a rate of 12.7% per year. It was the period of the *economic miracle* in which the vertiginous increase in industrial exports boosted the growth of manufacturing production, GDP and investment in fixed capital.

With the first oil shock in 1973, the pace of Brazilian development slowed down. In the period 1974-1981, the average annual growth of the GDP decreased to 5.4%, less than half of that observed in the period 1968-1973. The response of the military dictatorship is to adopt a *growth model based on foreign savings*, which led to excessive external debt and the financial crisis of the 1980s. In fact, the external debt rose from 13,962 million dollars in 1973 to 71,778 million dollars in 1981, that is, an increase of more than 500% in just eight years.

Regarding the policy of growth with foreign savings, Bresser-Pereira notes that "external indebtedness was intended to finance current account deficits, which, it was hoped, would increase the rate of capital accumulation. However, although consumer goods were not directly imported, these deficits also led to increased levels of consumption, insofar as they appreciated the national currency and implied an artificial increase in wages. When, at the end of 1973, the price of oil quadrupled, it would be natural to change the policy of current account deficits and external indebtedness. However, this was not what happened. The euphoria of the *economic miracle* infected Brazilian economic policy. When, in 1974, the miracle had already ended, and the world was confronted with the consequences of the first oil shock (1973), the president who took office, General Ernesto Geisel, declared Brazil an "island of prosperity" while he formulated in grandiose terms the II *National Development Plan* (II PND). To finance this plan, it decided to resort to foreign savings, and state-owned companies were given the task of borrowing in dollars, while the government make then to contain their prices to control inflation. This unacceptable price restraint will be the origin of the crisis of these companies in the following decades" (Ibid, p. 228).

The political coalition formed in 1977 by businessmen, intellectuals, workers and the Catholic Church, the so-called "Popular Democratic Pact", was successful in the objective of democratizing the country and in establishing the bases for an effective *Social Welfare State* in Brazil from the 1988 Constitution. However, due to the economic populism adopted by the Sarney government, which led to the failure of heterodox

stabilization plans; developmentalism was discredited and gave way to the liberal-dependent strategy adopted by the Collor government (1990-1992).

In this context, the failure of the Cruzado Plan was emblematic of the inability of the political coalition of the "Democratic Popular Pact" to resolve the serious macroeconomic imbalances of the Brazilian economy and resume the trajectory of economic development. In this regard, Bresser-Pereira states that:

> “At the beginning of 1986, the government launched the Cruzado Plan, which would become the great missed opportunity of the new democracy and the economists who had been so critical of the orthodoxy of the 1981-1984 period. Although well outlined, because it was based on the most important contribution of Latin American economists to economic theory – the theory of inertial inflation – the plan failed. The immediate causes of its failure were the fact that the imbalance in relative prices, which is inherent to inertial inflation, was not sufficiently corrected by the table for the conversion of forward purchase contracts (...); the government's inability to contain aggregate demand, as it did not reduce the public deficit or practice a rigid monetary policy; the increase in wages carried out on the day of the plan; and, mainly, the appreciation of the real exchange rate caused by the increase in wages above productivity. Faced with this fact, which resulted in a high current account deficit, and an external debt that was already high, external creditors again lost confidence, the rollover of the external debt was interrupted, and the balance of payments crisis was unleashed while inflation returned with full force" (Ibid, p.269).

The *liberal-dependent pact* was formed in Brazil in 1991 during the government of Fernando Collor de Mello, being dominant until 2005. It is a coalition of interests formed by rentier capitalists, finance professionals and part of the urban middle class. It is a liberal pact because it rejects developmentalism and the role of the State in the process of economic development. It is dependent because it implies a political alliance with the elites of the rich countries, which have begun to impose their agenda of economic and institutional reforms on Brazil. These reforms were based on the *so-called Washington Consensus*, which established that the "causes of the economic crisis in Latin America were basically twofold, namely: (1) excessive state growth, translated into protectionism (the strategy of industrialization by import substitution), excessive regulation, and inefficient and overnumbered state-owned enterprises; and (2) economic populism,

defined by the inability to control the public deficit and to keep the wage demands of the public sector under control" (Ibid, p.298).

The adoption of the precepts *of the Washington Consensus* in Brazil led to the process of trade and financial opening in the early 1990s, imposing the end of the neutralization of the Dutch disease and the resumption of the chronic trend of exchange rate overvaluation. The result of this was the early deindustrialization and semi-stagnation of the Brazilian economy for almost two decades.

However, the period of validity of the Liberal-Dependent Pact had a very positive aspect. It was during this period that the Real Plan was implemented, which allowed the end of high inflation through the introduction of a strategy to neutralize inflationary inertia, which was rigorously heterodox in nature. About the Real Plan, Bresser-Pereira comments that:

> “The Real Plan, which would put an end to high inflation on July 1, 1994, began to be developed in October 1993. The strategy of freezing prices had politically exhausted itself. Thus, when the Cruzado team reestablished itself in government, the Real Plan it conceived aimed to neutralize high and inertial inflation through a monetary reform that would instantly reduce inflation. The original idea was to have two currencies coexisting at the same time, as had happened in Bulgaria in 1920: the old currency, in which inflation would be high; and a new pegged currency. This dual system would allow agents to convert their contracts, voluntarily and according to the market, from the old currency, in which the contracts incorporated the expectation of inflation, to the new currency, which – because it was pegged to the dollar – did not require the contracts to include that expectation. Thus, now when the monetary reform eliminated the old currency, inflationary pressures, derived from relative price imbalances and the fact that, in inertial inflation, prices change in a lagged and non-synchronized way, would be absent" (Ibid, p.315).

Despite the success of the Real Plan in neutralizing high and inertial inflation, Brazil did not resume the GDP growth rates seen in the period 1950-1980. This is because in the post-Real Plan period, the so-called *trap of high interest rates and overvalued exchange rate* was crystallized, which would result in a low stimulus to capital accumulation. In fact, between 1994 and 2005 the investment rate remained below the

level of 18%, insufficient to provide a GDP growth rate higher than 3% p.a. in the average of the period under consideration. In the first term of President Fernando Henrique Cardoso, the interest rate-exchange rate trap was the result of the adoption of the *growth model with foreign savings*, in which the capture of foreign savings through the maintenance of a high real interest rate, which had as a counterpart a strong exchange rate appreciation, was seen as indispensable for the increase of savings and investment. This policy, however, proved to be ineffective in promoting the increase in savings, since it only induced *the replacement of domestic savings by foreign savings*, while, by reducing the rate of return on investment projects, due to the exchange rate appreciation, it ended up discouraging investment.

In the transition from the first to the second term of President Fernando Henrique Cardoso, the semi-fixed exchange rate regime (a system of crawling exchange rate bands) is abandoned in favour of the fluctuation of the exchange rate. Monetary stability becomes the responsibility of *the inflation targeting regime*, in which the monetary authority is responsible for obtaining a predetermined numerical value for the inflation rate through the manipulation of the nominal short-term interest rate, the Selic rate. The problem is that Brazil did not have the necessary conditions for the implementation of an inflation targeting regime. In the words of Bresser-Pereira:

> "In 1999, Brazil was not ready for a policy of inflation targeting, because it can only make some sense when one starts from a situation of macroeconomic equilibrium and wants to prevent the country from losing this equilibrium. However, this was not the case for us. The inflation targeting policy was designed in rich countries to manage a certain monetary policy regime, not to change it. Brazil, which since the trade and financial opening of 1990-92, had been trapped in a situation of high interest rates and low exchange rates, needed to change its monetary policy regime through a concerted strategy, aiming to lower the basic interest rate and keep the exchange rate relatively depreciated, at a competitive level (...) in addition, the deindexation promoted by the Real Plan had not been complete. Public concession contracts, which correspond to about 30% of the Brazilian economy, continued to be indexed by specific price indexes. It is this indexation that explains why inflation falls little in times of slowdown in the Brazilian economy" (Ibid, p.337).

The failure of the Fernando Henrique Cardoso government to resume the development of the Brazilian economy allowed Luiz Inácio Lula da Silva to win in the 2002 presidential election, against the PSDB candidate, José Serra. Due to the macroeconomic imbalances inherited from the end of Fernando Henrique's second term - inflation on an upward trajectory and the threat of sovereign default due to the vertiginous growth of public debt - the first two years of President Lula's term were characterized by the deepening of the economic policy inherited from the previous period, based on the so-called *macroeconomic tripod*, composed of the inflation targeting regime, generation of a significant primary surplus and the exchange rate fluctuation regime.

After the outbreak of the political scandal of the so-called *mensalão* in 2005, there was a progressive change in the orientation of the economic policy of the Lula government. In fact, there is a return of developmentalism, but now in a "social-developmentalist" guise. As during the period of the industrialization strategy based on import substitution, the domestic market is once again seen as the engine of long-term growth. Thus, the government's economic policy is aimed at fostering the domestic market through the expansion of social spending and a significant increase in the minimum wage to improve income distribution and thus stimulate the emergence of the mass consumption market. Given the spectacular increase in the terms of trade since 2005 in the wake of China's strong economic growth, this policy of *inward development* is not incompatible with the external balance. On the contrary, until 2007 Brazil accumulated surpluses in the current account of the balance of payments.

The combination of the appreciation of the terms of trade, the maintenance of high real interest rates and the absence of mechanisms to neutralize the Dutch disease generated a very strong appreciation of the real exchange rate in the period 2005-2011. The result of this exchange rate appreciation process was the continuity of the process of deindustrialization of the Brazilian economy. In fact, the share of the manufacturing industry in the GDP is reduced from just under 20% in 2005 to close to 13% in 2012. The effect of this process of deindustrialization was felt, in full force, in the government of President Dilma Rousseff, when the pace of economic growth, which had accelerated to about 4% p.a. on average in the 2003-2010 period, was reduced to less than 2% p.a. in the 2011-2014 period.

3. Does the adoption of a competitive exchange rate imply a wage squeeze?

A common criticism of new developmentalism is that the economic policy advocated by this school defends the reduction of real wages to encourage the reindustrialization of Brazil, thus being a *re-edition* of the *wage squeeze* that occurred during the military government in the period immediately prior to the *economic miracle*. This is because the achievement of a competitive exchange rate – the *so-called industrial equilibrium exchange rate* – would imply a reduction in real wages (given the productivity of labour and the mark-up rate of domestic enterprises) and in the share of wages in the national income; it is, therefore, a policy contrary to the interests of workers. In addition, many critics accuse the new developmentalists of deliberately *hiding from public opinion* the effects of their proposed exchange rate policy on wages.

That criticism is, however, totally unfounded. In the first place, it should be made clear, it is not correct to say that the economists of the new developmentalism seek to hide from the public debate the (temporary) effects of the exchange rate devaluation on the real wages of workers. This issue is explicitly addressed in chapter 16 of the book "*Developmental Macroeconomics: New Developmentalism as a Growth Strategy*" authored by Luiz Carlos Bresser-Pereira, José Luis Oreiro and Nelson Marconi and published in 2015 by *Routledge* in the United Kingdom. The Portuguese version of the book was published in 2016 by the publisher Campus and is therefore fully available to Portuguese-speaking readers. In addition, the same theme was recently addressed by Oreiro (2018) and Oreiro, Martins da Silva and Dávila-Fernandez (2020). It follows, therefore, that the assertion that the new-developmentalist authors hide from the public their "perverse plans" against the interests of the working class is false.

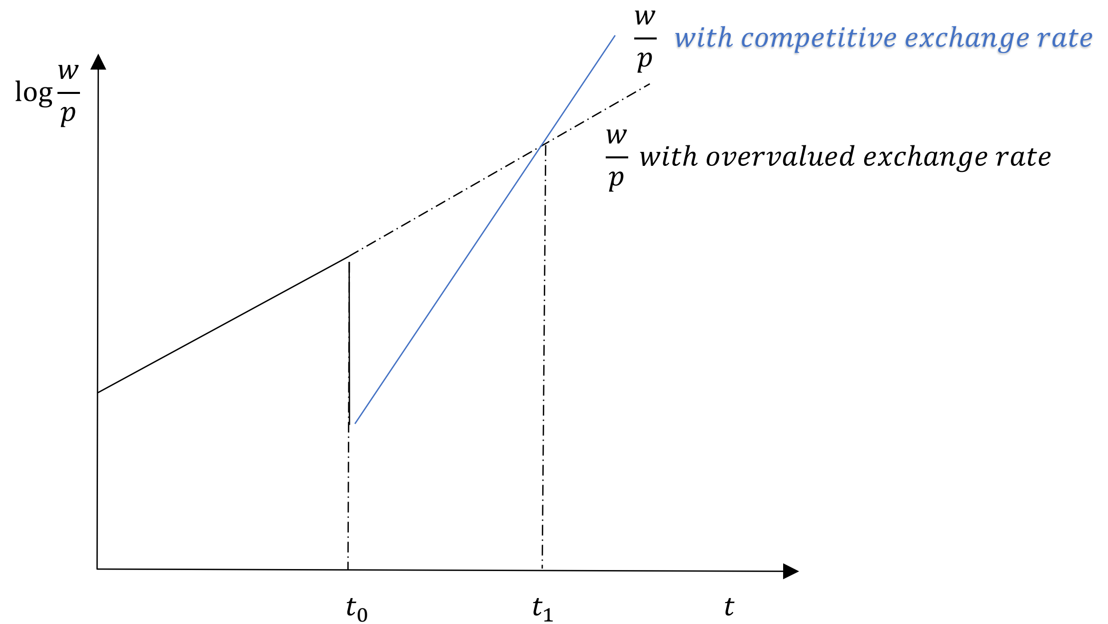
The New-Developmentalist argument is much more elaborate than the "straw man" elaborated by the critics of this school[9]. The argument of the new developmentalists is that an exchange rate maintained at a competitive level **for a sufficiently long period of time** (Oreiro, 2020) will induce a change in the productive structure of the Brazilian economy, encouraging the increase in the participation of the manufacturing industry and sophisticated services in the GDP (Oreiro, D'Agostini and Gala, 2020), which should result in an increase in the ratio between the income elasticity of exports and imports, thus enabling an increase in the growth rate compatible with the intertemporal balance of

[9] An example of this type of criticism can be found in The New Developmentalist 'Alchemists' Are Coming! (pragmatismopolitico.com.br)

payments. In a *dual economy* (Lewis, 1954), as is the case of the Brazilian economy, in which there is a large contingent of workers in the informal or subsistence sector of the economy, the restriction to long-term growth is not given by the availability of labour (or capital), but by the restriction of the balance of payments. As argued by Thirlwall and Dixon (1979), in economies in which the income elasticity of imports is greater than one (as is the case of the Brazilian economy), the balance of payments restriction necessarily imposes that exports grow at a rate higher than the growth of the gross domestic output; In other words, the *export coefficient should increase over time*. If growth is led by domestic demand, the economy will, sooner or later, enter a balance of payments crisis (Oreiro and Costa Santos, 2023a). Thus, the acceleration of growth not only requires that exports be an important engine of the country's demand growth, but also that the exchange rate be maintained at the level necessary to induce - together with a well-thought-out industrial policy - a process of structural change that allows the gradual relaxation of the balance of payments restriction.

The reindustrialization of the economy, obtained by maintaining a stable and competitive real exchange rate together with the adoption of an industrial and science and technology policy that acts effectively to reduce the *technological gap* (Oreiro, D'Agostini and Gala, 2020), will act to transfer labour from sectors with low per-capita added value, where wages are lower, to sectors with high value added per capita, where wages are higher. *This structural change will therefore increase both the level and the growth rate of real wages*, so that, after a certain interval of time, real wages will be higher than they would have been if the economy had remained at an overvalued exchange rate (Figure 1). In the medium and long term, workers can only gain from the structural change of the economy proposed by New Developmentalism.

Figure 1



We cannot deny, however, that here we are faced with an important political obstacle to the *new-developmentalist model*. Its implementation involves a redistribution of income in favour of profits, with an initial, albeit temporary, reduction in real wages. So how could workers be persuaded to join a developmentalist class coalition? To answer this question, we must keep in mind that the effect of currency devaluation on the *functional distribution of income* can be offset by a combination of progressive taxes on high incomes (e.g., inheritance tax, *high-value real estate*) and distributed profits; as well as by the decrease in financial gains through a significant reduction in the interest rate[10]. which would reduce the *concentration of personal income distribution*. As investments rise, domestic savings will continue to grow, and trade surpluses will also continue to

[10] To this end, it is necessary to change the *macroeconomic policy mix* in Brazil, from the combination of fiscal expansion (due to the increase in the growth of government consumption at a rate higher than real GDP) and monetary contraction, which characterized most of the period 1999-2015; to a combination of tight fiscal policy (with a reduction in the share of government consumption in GDP) and loose monetary policy. It is also essential to eliminate the use of the Selic as an index of public debt, in order to make room for its reduction due to the increase in the effectiveness of monetary policy (Oreiro, Punzo and Araujo, 2012); And, in addition, progress must be made in the process of deindexation of the Brazilian economy, including here the change in the minimum wage adjustment rule, correcting it according to the average adjustment observed in the private sector, and making it possible that in the years in which the productivity of the economy grows, this gain is passed on to the minimum wage. Wage negotiations, when widely approved by workers, should make it possible to temporarily reduce wages in exchange for maintaining employment in periods of recession.

contribute to this increase in domestic savings, thus reducing the change in the functional distribution in income necessary for macroeconomic equilibrium.

Finally, we must emphasize that the maintenance of an overvalued exchange rate is not in the interest of the working class, since the overvaluation of the exchange rate generates *premature deindustrialization*, causing labour to be transferred to sectors of activity in which the per-capita value added is lower and, therefore, wages are also lower. In this way, *the average real wage of the economy is reduced* due to the negative effect of the overvalued exchange rate on the employment structure of the economy. In this context, it should be noted that the fundamental characteristic of an underdeveloped economy is precisely that it has an archaic employment structure, even if the production structure is eventually relatively modern[11]. The overvaluation of the exchange rate contributes, therefore, to perpetuate an underdeveloped economic structure.

4. Dutch Disease, Exchange Overvaluation and Environmental Devastation.

One of the main propositions of new developmentalism is that the existence of abundant natural resources in a country generates an unbalanced productive structure (Diamand, 1972), that is, a productive structure in which the unit cost of production of primary goods is not only lower than the international cost of production of these goods, but also lower than the unit cost of production of manufactured goods. Thus, the supply

[11] In the words of Furtado (2009) "(...) Underdevelopment is not a necessary stage in the process of formation of modern capitalist economies. It is in itself a particular process, resulting from the penetration of modern capitalist companies into archaic structures (...) the most complex case – an example of which the current stage of the Brazilian economy offers us – is the one in which the economy has three sectors: one, basically subsistence; another, focused mainly on exports, and the third, as an industrial nucleus linked to the domestic market, sufficiently diversified to produce part of the capital goods it needs for its own growth. The industrial nucleus linked to the domestic market develops from a process of substitution of manufactured goods previously imported, that is, under conditions of competition with foreign products. From this it follows that the main concern of the local industrialist is to present an article similar to the imported one and to adopt production methods that enable him to compete with the foreign exporter (...) the practical result of this – even if the industrial sector linked to the domestic market grows and its participation in the product increases, even if the per-capita income of the population as a whole grows – the occupational structure of the country changes slowly. The contingent of the population affected by economic development remains small, and the relative importance of the sector whose activity is production for subsistence is declining very slowly. It is explained, in this way, that an economy where industrial production has already achieved a high degree of diversification and has a share in the product that is little different from that observed in developed countries has a typically pre-capitalist occupational structure and that a large part of its population is oblivious to the benefits of economic development" (pp. 171-172).

price of primary goods (the one that incorporates the normal rate of profit in the domestic economy) must be lower than the supply price of manufactured goods, that is:

$$p_p < p_m \quad (1)$$

Where: p_p is the supply price of domestically produced primary products and p_m is the supply price of domestically produced manufactured products.

In economies where the productive structure is balanced, in turn, the unit costs of production of primary and manufactured goods are approximately equal, since the levels of labour productivity in both sectors of economic activity are similar. In this context, the supply price of primary goods produced in these economies is approximately equal to the supply price of manufactured goods, that is:

$$p_p^* = p_M^* \quad (2)$$

Onde: p_p^* is the supply price of primary goods produced in economies with a balanced productive structure and p_M^* It is the supply price of manufactured goods produced in economies with a balanced productive structure.

Primary goods are generally homogeneous goods traded in competitive international markets in such a way that the *law of the single price must prevail*: the price of primary goods produced domestically must be equal to the price in domestic currency of primary goods produced in the rest of the world, i.e.:

$$P_p = Ep_p^* \quad (3)$$

Where: E is the nominal exchange rate, that is, the price of the currency in economies with a balanced productive structure in terms of the currency in the domestic economy.

We then have the following relations:

$$p_p < p_m \quad (1)$$

$$p_p^* = p_M^* \quad (2)$$

$$P_p = Ep_p^* \quad (3)$$

Substituting (2) in (3) and the resultant in (1) we have:

$$p_m > Ep_M^* \quad (4)$$

In expression (4) we observe that, at the level of the exchange rate that equalizes the domestic and international prices of primary goods, the supply price of domestic manufactured goods will be higher than the price in national currency of manufactured goods produced in economies that have a balanced productive structure. It follows that, although primary goods are competitive in international markets, manufactured products are not. For manufactured goods to be competitive in international markets, it would be necessary for the exchange rate to be high enough (depreciated) to equalize the national and international prices of manufactured goods. The exchange rate for which the equalization rate occurs is the industrial equilibrium exchange rate (Ei).

We get:

$$E_i = \frac{p_m}{p_m^*} \qquad (5)$$

It should be noted that in a *freely floating exchange rate regime*, there is no reason to expect the exchange rate to assume the value necessary to make exports of manufactured goods competitive. The exchange rate should fluctuate around a level that equalizes the domestic and international prices of primary goods, which will be an *overvalued exchange rate* level from the point of view of the production and export of manufactured goods. As a result of this overvaluation, the share of manufactured goods in the export basket will gradually be reduced, while the domestic production of manufactured goods will be replaced by imports. The Dutch disease will therefore result in a reprimarization of exports and the premature deindustrialization of the domestic economy.

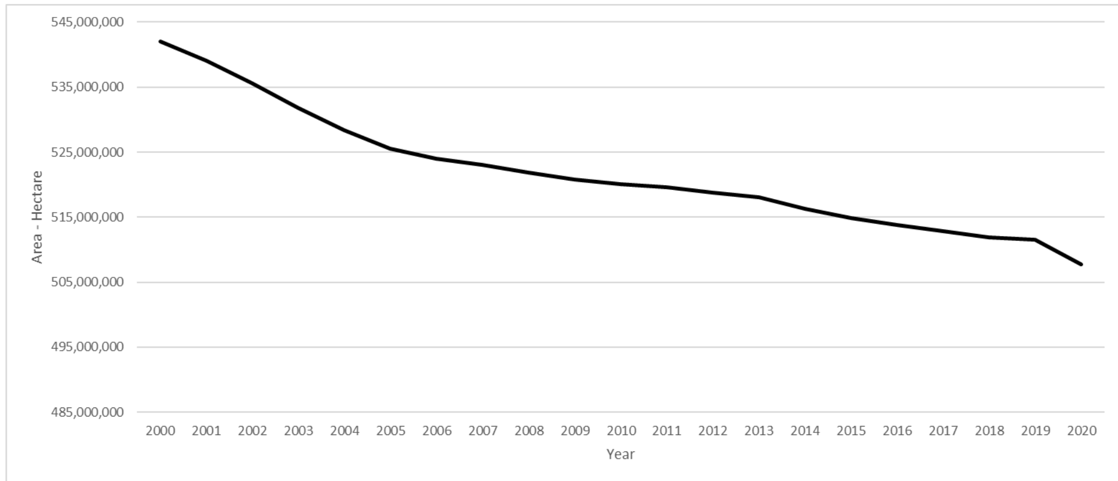
This is the well-known and widely disseminated part of the economic literature and debates on the conduct of exchange rate policy in countries like Brazil. But that's only the known part of Dutch disease. The unknown or ignored part is the *impact of the Dutch disease on the environment*.

The production of primary goods, such as soybeans and beef, is land-intensive, but extremely profitable in Brazil because land is abundant. The continuous increase in the production and export of soybeans and beef requires an increasing occupation of land, bringing the agricultural frontier to the limits of the Amazon rainforest. Producers on the agricultural frontier have no choice but to cut down the forest to occupy new spaces for soybeans and meat production. This occupation occurs, in general, through illegal burning and deforestation, which has a clear and negative effect on CO2 emissions, thus

contributing to the phenomenon of climate change associated with the increase in the planet's average temperature. Thus, the Dutch disease results, on the one hand, in reprimarization and premature deindustrialization of the Brazilian economy and, on the other hand, in environmental degradation, with negative externality effects throughout the planet.

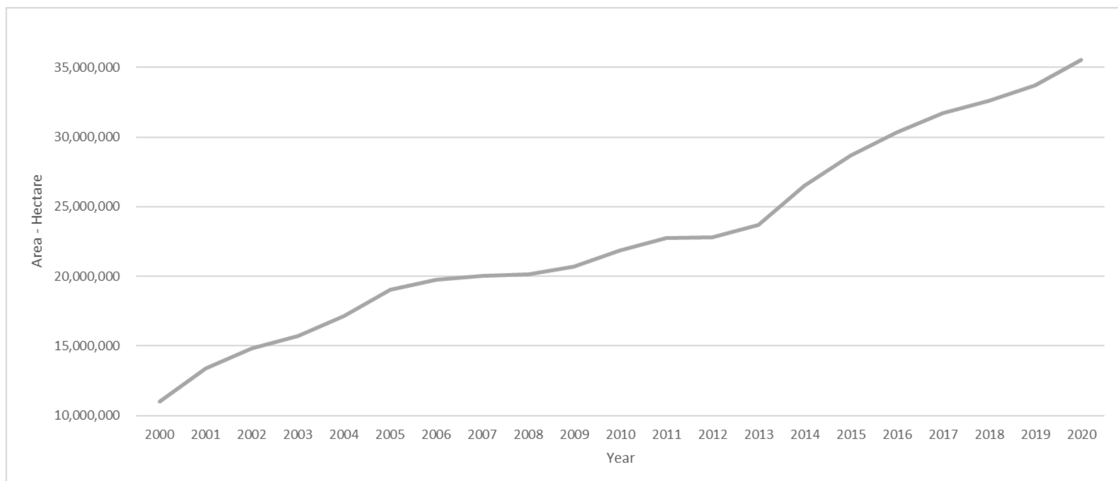
What to do to eliminate Dutch disease? A simplistic solution would be the adoption of *an managed exchange rate regime*, in which the monetary authority is willing to use the necessary instruments (reduction of the interest rate, introduction of controls on the inflow of capital, etc.) to produce an exchange devaluation at a level compatible with the industrial equilibrium. But the exchange rate devaluation, by itself, does not eliminate the problem of Dutch disease, since the profitability of the production and export of primary goods will be even higher at an exchange rate level that makes the production and export of manufactured goods internationally competitive. The medium and long-term result of this policy will be the redirection of domestic investment from the production of manufactured goods to the production of primary goods (*rebound effect*), aggravating the problems of reprimarization of the exports and premature deindustrialization, as well as the process of destruction of the Amazon forest, which can be seen in figures 2(a) and 2(b) below:

Figure 2(a) Land cover by forests in Brazil (2000 – 2020), Area-Hectare million.



Source: MapBiomas Project, 2022. Collection 6.0 of the Series of Maps of Land Use and Cover in Brazil. Prepared with the help of Daniel Moura (UnB/SDMRG).

Figure 2(b) Land cover by soybeans in Brazil (2000 – 2020), Area-Hectare million



Source: MapBiomas Project, 2022. Collection 6.0 of the Series of Maps of Land Use and Cover in Brazil. Prepared with the help of Daniel Moura (UnB/SDMRG).

Therefore, to eliminate the Dutch disease, it is necessary to introduce a tax on exports of primary goods. In this case, the new supply price of domestic primary goods will be given by:

$$p_p^{'} = (1+\tau)p_p \quad (5)$$

Where: τ is the export tax rate.

In those circumstances, the law on the single price implies that:

$$p_p^{'} = (1+\tau)p_p = Ep_p^{*} \quad (6)$$

The export tax rate should be high enough so that. In this case, the application of the law of the single price will make the production and export of manufactured products competitive at the exchange rate level that equalizes the domestic and international prices of primary products. Under these conditions, the profitability of industrial investment will be at least equivalent to the profitability of investment in the expansion of production and export of primary goods, reducing the economic incentive to environmental degradation.

In addition, the export tax will discourage the expansion of soybeans and beef production in areas covered by the Amazon rainforest due to higher logistics costs associated with greater distance from the processing, distribution and consumption centres of these goods. Given that Brazil is a relevant producer of soybeans and beef on the international market, the withdrawal of the least efficient producers will result in a contraction of the world supply of these products, thus increasing their price on the international market. In this way, the most efficient producers, located outside the legal Amazon region, will not have a permanent loss of income, having no reason to oppose the introduction of this tax, if they are able to correctly identify their medium and long-term economic interests.

From this reason, it is in the interest of environmentalists to introduce an export tax on primary products, as this tax reduces economic incentives for environmental degradation resulting from the expansion of the agricultural frontier towards the Amazon forest. In this way, *a developmentalist coalition for the twenty-first century can incorporate the defenders of the environmental agenda*, which includes broad sectors of the urban middle classes. On the other hand, the introduction of the export tax will not necessarily reduce the incomes of landowners in regions where beef and soy production are already firmly established, as we argued above. In addition, any economic losses suffered by producers, due to the collection of the tax, can be indirectly recovered by the partial or total use of the total collected to carry out infrastructure works that reduce the costs of transportation and storage of primary goods; as was recently done by the governor of the State of Goiás, Ronaldo Caiado, who created a state contribution on agricultural products to implement the State Infrastructure Fund (*Fundeinfra)* within the Goiás Infrastructure Agency (Goinfra).[12]

[12] Agro Tax: Ronaldo Caiado sanctions project that creates contribution on agricultural products in Goiás | Goiás | G1 (globo.com).

5. The Problem of Interest and Rentism in Brazil

Since the implementation of the Real Plan in Brazil in June 1994, the Brazilian economy has experienced extremely high real interest rates in international comparison. Initially, this problem was due to the adoption of the regime of crawling exchange rate bands by the Central Bank of Brazil in March 1995. In fact, the management of the exchange rate in a context of an open capital account, as in Brazil in the mid-1990s, significantly reduces the degree of autonomy of monetary policy, forcing the Central Bank to set the Selic interest rate at the level necessary to maintain the exchange rate within the bands defined by the current exchange rate regime. With the replacement of the exchange rate anchor by a new monetary anchor, namely, the inflation targeting regime in mid-1999; It was expected that the Brazilian economy would start to exhibit a real short-term interest rate compatible with the levels observed at the international level. This expectation, however, did not materialize. As can be seen in Table I below extracted from Oreiro and Paula (2021: 70), the real Selic interest rate in the period 2003-2016 exceeded by 257 b.p. the equilibrium interest rate[13] for the Brazilian economy, calculated by the sum of the real international reference interest rate[14] and the country risk premium measured by J.P. Morgan's EMBI+

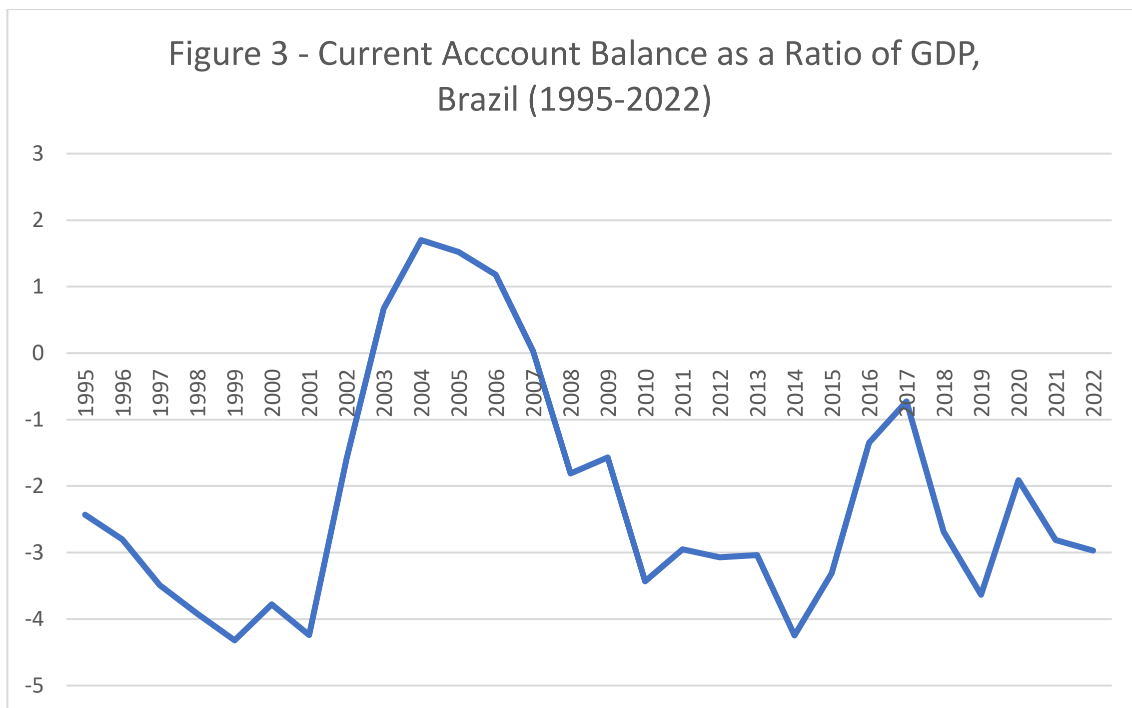
[13] Here a small digression is necessary on the concept of equilibrium interest rate. The conventional literature on the subject defines the neutral or equilibrium interest rate as the value of the real interest rate for which the inflation rate is kept constant over time. In macroeconomic models for closed economies, the equilibrium real interest rate is that value for which the output gap is equal to zero, that is, the economy operates with a level of activity equal to the potential (Blinder, 1998, p.32). For small economies with an open capital account, as is the case of the Brazilian economy, the relevant concept of equilibrium interest rate is not one for which the output gap is equal to zero; but the one that eliminates arbitrage gains between domestic bonds and foreign bonds. If the capital account is fully opened, then the equilibrium interest rate will be equal to the international interest rate. In the case where there are restrictions on capital mobility, as is the case in Brazil, then appropriate risk premiums should be added to the international interest rate (Barbosa et al. 2016). More specifically, the sovereign risk premium and the exchange rate risk premium should be added.

[14] The reference international interest rate is the US interest rate, since the United States is the world's leading financial center, and the dollar is the most important international reserve currency. But what interest rate should we use to calculate the equilibrium interest rate? In principle, the relevant interest rate for this purpose would be the *fed funds rate*, which is the rate set by the monetary policy committee (FOMC) of the Federal Reserve, the Central Bank of the United States. The problem is that in Brazil the Selic rate, set by the Central Bank of Brazil at COPOM meetings, is also the index of a significant part of the federal public debt securities, more specifically, the Treasury Financial Bills (LFT's). The existence of public debt securities indexed to the Selic rate generates a *problem of contagion of monetary policy by public debt* (Barbosa, 2006), making the short-term interest rate, determined by the Central Bank to regulate the liquidity of the interbank reserves market and thus operationalize the monetary policy with a view to achieving the inflation target; has to be equal, as a result of arbitrage operations, the interest rate of federal public debt securities. Thus, the relevant international interest rate for determining the equilibrium interest rate of the Brazilian economy is not the *fed funds rate*, but the interest rate of U.S. public debt securities whose maturity is like the average maturity of the Brazilian public debt. As the Brazilian public debt has an average maturity of around 4 years, it follows that the most appropriate US interest rate for calculating the equilibrium interest rate is *the interest rate of the 5-year maturity T-Note.*

Table I – Determinants of the Equilibrium Interest Rate of the Brazilian Economy, average 2003-2016.	**Average 2003-2016**
Real interest rate on 5-year T-Notes	0,45% a.a.
EMBI + Brasil	323 b.p
Equilibrium interest rate	3,68% p.y
Selic-Over real rate	6,25% p.y
Monetary tightening	**2,57%**

Source: Oreiro and Paula (2021: 70).

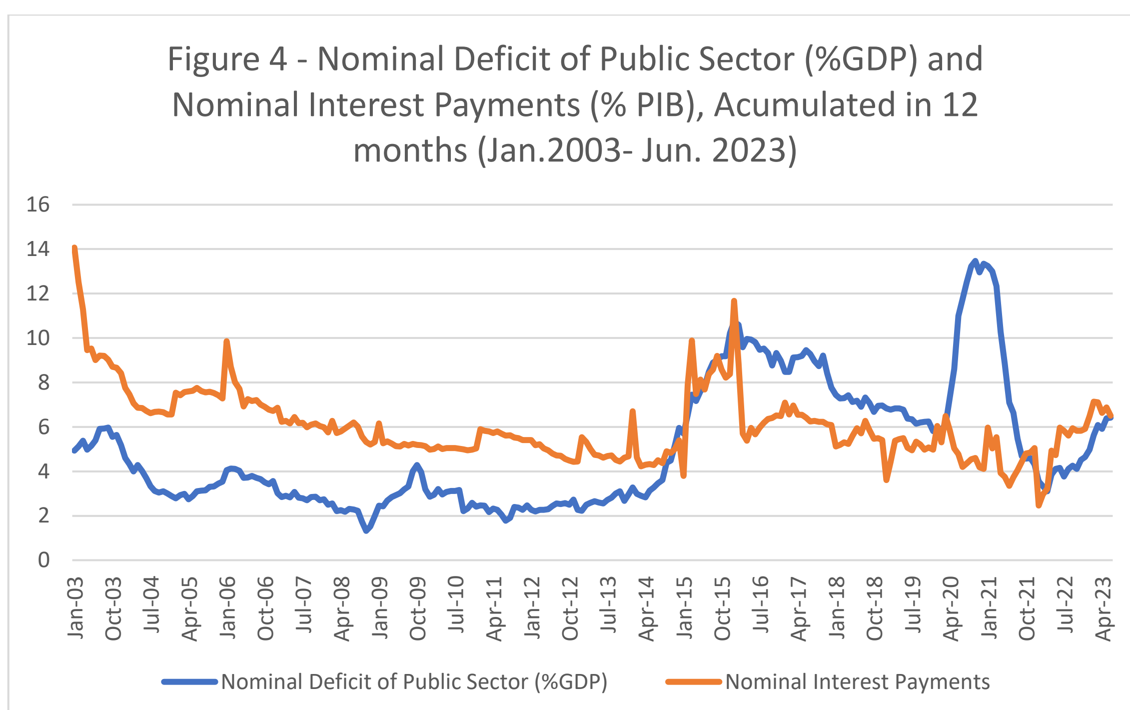
The maintenance of the real interest rate at a level systematically higher than that prevailing at the international level gives rise to the inflow of speculative capital with the objective of obtaining arbitrage gains between domestic and international interest rates. This inflow of capital acts as *a second source of overvaluation of the exchange rate*, causing the exchange rate not only to be overvalued with respect to the level of industrial equilibrium, but also with respect to the equilibrium level *of the current account of the balance of payments*. Thus, a structurally high interest rate, as in the Brazilian case, ends up generating a *structural imbalance in the current account of the balance of payments*, as we can see in figure 3 below for the Brazilian case.



Source: IPEADATA.

Another consequence of the high level of interest rates observed in Brazil is the structural fiscal imbalance, which is manifested by a high nominal deficit of the public sector and a medium- and long-term trend of increase in the public debt/GDP ratio. In fact, as we can see in figure 4 below, the consolidated public sector paid an average of 6.03% of GDP, in the period between January 2003 and June 2023, as (nominal) interest on the public debt; while the nominal deficit of the public sector was, on average for this period, equal to 5.03%. *Thus, it is quite clear that, in the Brazilian case, the fiscal imbalance is of a purely financial nature.*

This fiscal imbalance of a financial nature, combined with the implementation of the fiscal rule of the Spending Ceiling at the end of 2016 by the Temer government, has led to a *progressive reduction in public investment in Brazil* (Pires, 2022), causing the federal government's net investment, equal to gross investment expenditure minus the net sale of non-financial assets, become negative from 2015 onwards, reaching the mark of -0.36% of GDP in 2021[15].



Source: Central Bank of Brazil. Elaborated by the author.

Based on these considerations, we can see that the high level of the Selic interest rate practiced in Brazil compared to the prevailing levels in the rest of the world are at the root of the external and fiscal imbalances. The question that arises, therefore, is to understand why the interest

[15] Public Investments: 1947-2021 | Fiscal Policy Observatory (fgv.br).

rate in Brazil is structurally high. A possible explanation was recently given by Oreiro and Costa Santos (2023b). According to these authors, the Brazilian economy still has a high degree of contract indexation, which acts to *increase inflationary inertia*, that is, the autoregressive component of the inflation rate dynamics. In this context, maintaining the inflation rate within the bands defined by the National Monetary Council, in the context of the framework of the inflation targeting regime, requires a greater dosage of *monetary tightening* - defined as the margin at which the Selic rate exceeds the neutral or equilibrium level - in the face of a supply or demand shock that generates inflationary pressures. The supply shocks resulting from the disorganization of global industrial input chains due to Covid-19 in the period (2020-2021) and the increase in energy and food prices resulting from the Ukraine War in 2022, led to an acceleration of inflation in Brazil and worldwide, but the increase in interest rates in Brazil was much faster and more intense than in the United States and the countries of the European Union (Oreiro and Weiss, 2023). This fact seems to point to an inefficiency of monetary policy in Brazil due to the inflationary inertia resulting from the indexation of contracts.

In addition to this more technical problem, so to speak, we are also faced with a clear problem of political economy. The financing of the public sector required the transfer of 6% of the GDP on average of the last 20 years to the hands of rentiers, a class of individuals composed of financial market agents, the upper middle class, large rural producers and even large businessmen in the productive sector. The interests of this social class are defended in the public debate by economists who work in the financial market and by the mainstream media that, in the current context of social networks and alternative information and entertainment platforms, strongly need the *marketing expenses* of banks, wealth managers, investment funds and other financial institutions to survive. This alliance between rentier interests and the mainstream media has managed to guide the economic debate in Brazil for at least the last 20 years, causing the focus of the debate to move away from the problem of interest rates and concentrate on other factors such as corruption or an alleged (sic) "fiscal irresponsibility" of the public sector. Proposals such as the monetary reform that consists of the elimination of all the mechanisms of indexation of contracts that still exist in the Brazilian economy never get the proper attention of the media, because they are not in the interest of the rentier class, which largely benefits from this situation.

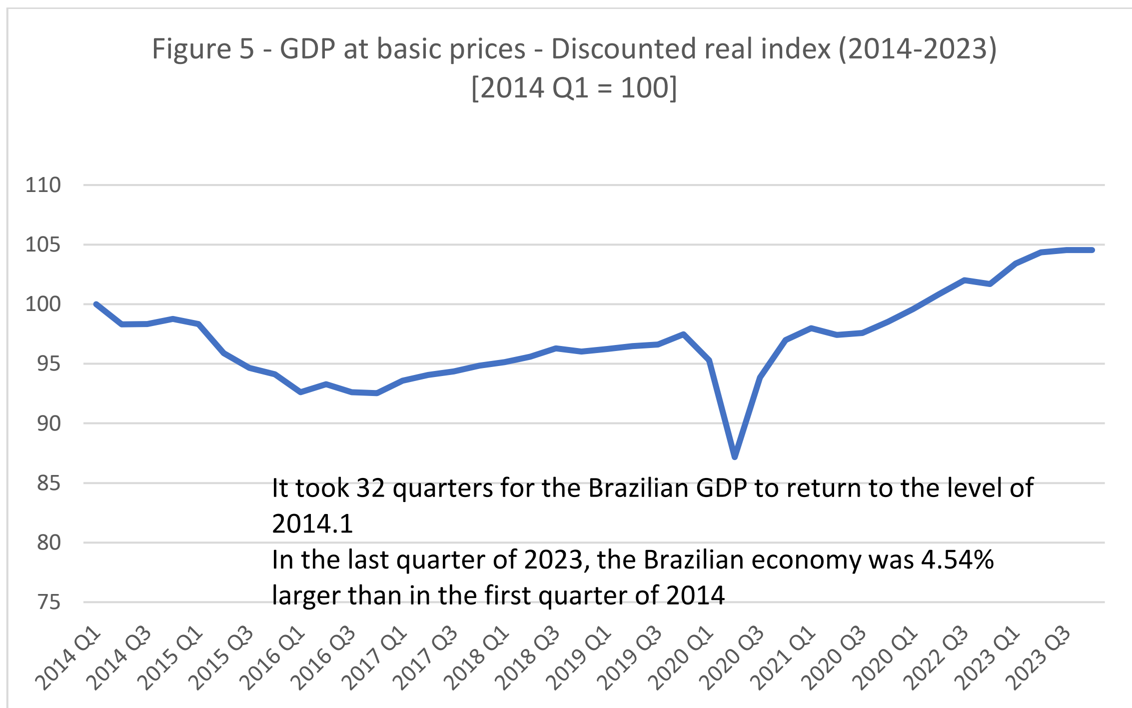
Reducing spending on interest payments on the public debt to an average of 3 to 3.5% of GDP would allow a reduction in the nominal deficit simultaneously with an increase in public investment and other social spending. In this way, it would be possible to reconcile medium and long-term fiscal sustainability with the resumption of economic growth on a socially inclusive

basis. To do so, however, it is necessary to re-enact a developmentalist class coalition capable of imposing a permanent political defeat on rentism. We will deal with the viability of this class coalition in the next section, which concludes this article.

6. **Is it possible to re-edit a developmentalist class coalition in Brazil**?

In section 2 of this article we show how the *developmentalist class coalition*, a concept created by Bresser-Pereira in his work The Political Construction of Brazil, plays a key role in the analysis of the process of industrialization and development of the Brazilian economy from 1930 to 1977 when it was replaced by the *popular democratic* pact whose objective was to promote the democratization of the country and promote social changes through the Social Welfare State established by the Federal Constitution of 1988. The inability of the democratic popular pact to overcome the high inflation of the 1980s together with the foreign debt crisis produced a lost decade in terms of economic development, opening space, in the 1990s, for the economic policy recommendations provided for by the *Washington Consensus* to be implemented in Brazil from a new coalition of classes. the *liberal-dependent coalition*. This new coalition, formed by the rentier capitalists, the finance professionals and part of the urban middle class, was successful in eliminating the problem of high inertial inflation with the Real Plan, but ended up producing the trap of high interest rates and overvalued exchange rates that will keep Brazil in a situation of *economic semi-stagnation*, temporarily and only partially reversed during the government of Luis Inácio Lula da Silva (2003-2010) due to the reorientation of the government's economic policy towards the so-called *social-developmentalism* that advocated the resumption of economic development through the growth of the domestic market, driven by the policy of increasing the minimum wage and by social assistance policies such as the *Bolsa Família*. As the interest rate-exchange rate trap was not undone during the Lula government, the result was a temporary acceleration of growth at the expense of the continuation of the premature deindustrialization of the Brazilian economy and the repression of its exports. This negative structural change will reduce the dynamism of the growth of the Brazilian economy from 2011 onwards, enabling the return of the liberal-dependent class coalition after the impeachment of Dilma Rousseff, in the Temer and Bolsonaro governments.

The Temer-Bolsonaro period was marked by the *long agony* of the Brazilian economy (Oreiro, 2023), in which the level of economic activity was below the peak recorded in the second half of 2014, as we can see in figure 5 below.



Fonte: IPEADATA. Elaboração do autor.

In October 2022, Luis Inácio Lula da Silva is elected for a third term as President of the Republic after defeating, by a narrow margin, Jair Bolsonaro and, consequently, the radical version of the liberal-dependent pact. In this context, the central question to be answered is whether President Lula will be able to re-edit a developmentalist coalition capable of putting into practice a macroeconomic policy regime aligned with new developmentalism.

The arguments presented in this article point to a "maybe". As we have argued throughout the article, the resumption of economic development requires the reindustrialization of the Brazilian economy, something that is in the interest of the working class and a large part of the urban middle class. Reindustrialization requires the neutralization of the Dutch disease and a monetary reform in order to eliminate the problem of high interest rates and overvalued exchange rates that have been the cause of the premature deindustrialization of the Brazilian economy. The neutralization of the Dutch disease requires the introduction of an export tax on commodities, which goes against the most immediate interests of agribusiness, but can be supported by environmentalists based on the realization that the Dutch disease is an important driver of the devastation that the Amazon rainforest has suffered in the last 30 years in Brazil., a fundamental factor for understanding the climate changes underway on planet Earth. In this way, *a new coalition of developmental classes can be integrated by environmentalists,* a group composed of scientists, intellectuals, part of the urban middle class, and even sectors of the financial market that

have realized the enormous opportunities for profit to be explored with the transition to a low-carbon economy.

The reduction of structurally high interest rates in Brazil requires, among other factors, the realization of a *monetary reform*, which goes against the interests of rentiers. However, it is possible to convince entrepreneurs in the productive sector, which includes representatives of industry, commerce and services, that it is in their interest in the medium and long term to have a structurally lower interest rate. This will not only encourage an increase in domestic consumption of durable goods, which are generally financed by bank credit, but will also allow for a significant reduction in interest payments on the public debt. This reduction, in turn, will allow the reduction of the nominal deficit of the public sector, which is essentially financial in nature, while at the same time making room in the government budget for the increase in public investment, which should accelerate the pace of economic growth, and for the increase in spending on social assistance. In this way, it will be possible to reconcile fiscal sustainability with the resumption of economic growth with social inclusion.

It is up to President Lula to sew the necessary alliances to make this new coalition of classes feasible and the implementation of a new-developmentalist model adapted to the scenario imposed by climate change. The objective conditions for the emergence of this new coalition, however, are already in place. Time will tell if President Lula will be successful or not. If this new developmentalist coalition in Brazil is implemented, a relevant part of the merit will go to Professor Luiz Carlos Bresser-Pereira who, with his seminal contributions to economics and political science, allowed the political construction of a new-developmentalist alternative for Brazilian society.

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