

## Exchange rate policy, class conflict and economic development from Furtado's view

*Política cambial, conflito de classes e desenvolvimento econômico na perspectiva de Celso Furtado*

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RESUMO: O objetivo do trabalho é analisar as contribuições de Celso Furtado quanto ao papel da política cambial e sua relação com o conflito de classes no desenvolvimento de economias periféricas. Resgatam-se as interpretações do autor em suas análises sobre o caso venezuelano e em *Formação Econômica do Brasil*. Nessas obras destacam-se duas principais conclusões: i) a valorização cambial, em consequência da maldição dos recursos naturais, prejudica o crescimento econômico; ii) a condução da política cambial é um fenômeno associado à economia política, em que o conflito de classes torna-se eminente. A conclusão ressalta a atualidade do pensamento do autor.

PALAVRAS-CHAVE: Desenvolvimento econômico; política cambial; conflito de classes.

ABSTRACT: The aim of this paper is to analyze the contributions of Celso Furtado regarding the role of exchange rate policy and its relation to social conflict in the economic growth of peripheral economies. For that, we revisit Furtado's analyses about the Venezuelan case and in *The Economic Formation of Brazil*. We highlight two main conclusions from such works: i) exchange rate appreciation due to a natural resources curse harms economic growth; ii) exchange rate policy is mainly a phenomenon associated with political economy, in which social conflict emerges. Hence, we claim that Furtado's analyses are still significant today.

KEYWORDS: Development; exchange rate policy; social conflict.

JEL Classification: B1; B5.

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\*Fabricio Missio thanks the support from Capes and CNPq.

## INTRODUCTION

Exchange rate policies have been advocated since the beginning of the upward surging evidence between real exchange rate (RER) management and economic growth. Rather than considering RER as a neutral variable (or even that devaluation may have contractionary effects), many authors claim that a devaluated RER fosters economic growth, particularly in developing countries (Dollar, 1992; Rodrik, 2008; Gala and Libânio, 2011; Missio, Jayme Jr., Britto and Oreiro, 2015).

Among the main arguments of such literature, we highlight two important discussions. Firstly, the Dutch disease effects, which suggest that exchange rate overvaluation resulting from natural resources curse harms accumulation and growth. Secondly, the connection between exchange rate policy and class conflict.<sup>1</sup> Celso Furtado discussed both of these in his work.

Therefore, the aim of this paper is to analyze Furtado's contributions regarding these topics. To this end, we examine his contributions in "Recent Venezuelan economy development" (1957), "Notes on Venezuelan economy and its current perspectives" (1974)<sup>2</sup> and in *Economic Growth of Brazil* (1959 [1974]) (hereafter *EGB*). By doing so, we suggest that Furtado had already pointed out the main issues for this debate. Moreover, his contributions were particularly original.

From Furtado's point of view, the exchange rate by itself was not capable of stimulating economic growth. He was very skeptical about the role played by RER devaluation as means of boosting production and industrialization. Indeed, this skepticism is common in the Latin American structuralism tradition (Díaz-Alejandro, 1963; Krugman and Taylor, 1978; Arida and Bacha, 1984).<sup>3</sup>

Following Bresser-Pereira and Rugitsky (2015), Prebisch (1959) was one of the first authors from this tradition to consider protectionism and exchange rate policy as feasible alternatives to promote growth, though he preferred the former. He argued that selective taxes tend to be less harmful to price systems than RER's devaluations. Indeed, the skepticism about exchange rate policy (or even its ineffectiveness) was dominant in the Cepal tradition. Fajnzylber (1988) considered that competitiveness based upon low wages, subsidies and devalued currency was "spurious". In fact, this skepticism is associated with the view that chronic balance payments (BP) imbalances were mainly due to the endogenous growth process of a dual economy (peripheral). In other words, Furtado disagreed with the BP monetary theory (Boianovsky, 2012).

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<sup>1</sup> Class conflict (income distribution) impact on economic growth is not necessarily a new agenda, particularly in the new Kaleckian literature (see Bhaduri and Marglin, 1990; Skott, 1992; among others). Nevertheless, there is little research that concentrates on the relationship between exchange rate, income distribution and its effects on growth.

<sup>2</sup> In portuguese, both papers are known as "O desenvolvimento recente da economia venezuelana (1957)" e "Notas sobre a economia venezuelana e suas perspectivas atuais (1974)".

<sup>3</sup> For better knowledge of this tradition, as well as issues connected to this research agenda, see Boianovsky (2015) and Missio, Jayme Jr. and Oreiro (2015).

Their thesis claims that industrialization in peripheral economies was subject to its own historical laws, so that it would not automatically follow the same route taken by developed countries. Among the differences between both processes, the structural external imbalance of developing countries was much more relevant. To a certain extent, it was a natural outcome of the rising imports coefficient due to “spontaneous” growth. In a sense, it shows that capital accumulation relied on trade (Furtado, 1958, 1961; Szmrecsányi, 2001). Arguing with Nurske, Furtado made this point clear: How to conciliate this need to increase imports resulting from development with the impossibility to augment imports capacity? [...] The ultimate cause of imbalance is the disparity between income growth and import capacity”<sup>4</sup> (Furtado, 1952, p. 221).

From this perspective, in the short run, deficits were irreversible, unless higher unemployment, inflation and income concentration were acceptable.<sup>5</sup> Therefore, Furtado was reluctant to endorse exchange rate devaluation, since it would not solve the main problem underlying chronic BP imbalances. In his words, “[...] disequilibrium of the balance of payments is similarly a manifestation of structural anomalies. Unless these maladjustments can be foreseen and avoided, the cost of avoiding inflation and external disequilibrium is high: economic stagnation or, at least, a restricted rate of growth” (Furtado [1961] 1964, p. 168).

His skepticism about exchange rate devaluation as a means of dealing with BP imbalances is present in other papers where he examines the Mexican case, and in the book *Development and Underdevelopment*<sup>6</sup> (1961). In the former, the report made by Celso Furtado and Noyola presented an empirical investigation of external imbalances from a structuralist approach. Furthermore, at the very beginning there was a reference to a theoretical essay whose main conclusion, according to Boianovsky and Solis (2014, p. 45), was that “neither the overvaluation hypothesis nor that relating to the surplus of investment over savings’ explained the tendency towards disequilibrium in the balance of payments of developing economies. Instead, its origin ‘should be looked for in the actual structural changes that constituted economic development.” In the latter, at the end of chapter 5, such reasoning comes up again since the author does not give support to deflation and exchange rate devaluation policies, relying on a “positive orientation concerning the process of capital formation” (Szmrecsányi, 2001).

Nonetheless, in the Venezuelan case, where oil exports growth makes up for the lack of foreign currency, Furtado showed that the abundance of natural re-

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<sup>4</sup> “Como conciliar essa tendência a aumentar as importações, resultante do próprio desenvolvimento, com a impossibilidade de aumentar a capacidade para importar? [...] A causa última do desequilíbrio está na disparidade entre o crescimento da renda e o da capacidade para importar” (Furtado, 1952, p. 221).

<sup>5</sup> Throughout his work, Furtado mentions that the relation between technology imports from developed countries, income inequality and changes toward modernization of consumer pattern constrained Latin American industrialization (Cunha and Brito, 2018).

<sup>6</sup> In portuguese, the book is called *Desenvolvimento e Subdesenvolvimento* (1961).

sources (oil) prompted exchange rate overvaluation and productivity/competitive drawbacks. Hence, we believe that it is important to regain this perspective to assess the current debate on the Brazilian exchange rate policy.<sup>7</sup> As mentioned in the literature, one of the main problems of the Brazilian economy in the last decades is exchange rate overvaluation.

To accomplish this goal, apart from this introduction, the paper is divided in three sections. The next section discusses exchange rate policy in Venezuela in line with Furtado's approach. According to the author, the revenues from the exploitation of oil alleviated foreign exchange constraints and ensured a source to finance the government. However, simultaneously, it overvalues domestic exchange rate, preventing productive diversification and sustainable growth. In what follows (third section), we reassess the role played by exchange rate policy in *EGB*. Furtado shows that exchange rate policy is mainly a political decision, reflecting class conflict. The last section presents final statements and some insights to back the debate on Brazilian exchange rate policy.

## EXCHANGE RATE AND DUTCH DISEASE

In "Recent Venezuelan economy development", Celso Furtado developed an appealing interpretation of underdevelopment when there is excessive foreign currency. Particularly, he shows that there was a gap between the opportunity of fast technological modernization and the ongoing waste of foreign currency.

In other terms, Furtado presented the constraints to economic growth when RER is overvalued – called "Venezuelan singularity". Medeiros (2008) stresses that Furtado foresees the Dutch disease phenomena, as it later became known in the literature. That is, the conventional literature claims that the Dutch disease was identified in 1960 in the Netherlands, where the discovery of natural gas overvalued the currency and threatened the local manufacture. Nevertheless, Furtado had already pointed out the main arguments of this thesis.<sup>8</sup>

The author underscored that the Venezuelan economy was not externally constrained, particularly by the shortage of foreign currency, as it was in other Latin American countries. Oil revenues were sufficient to overcome this problem and even to finance a development project capable of riding out underdevelopment. However, the overflow of external resources caused exchange rate overvaluation, which

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<sup>7</sup> Brazilian RER has been overvalued since mid-1990. Nonetheless, in the first decade of 21<sup>st</sup> century, the Brazilian economy grew at a modest rate owing to a commodity international prices boom. In this period, RER has been overvalued. On one hand, BP imbalances was not a problem; on the other hand, the Brazilian economy lost competitiveness, especially the industrial sector.

<sup>8</sup> According to Boianovsky and Solís (2014, p. 24): "Furtado (1957) produced a study about the Venezuelan economy – an exception to balance of payments constraints in the region – arguing that the oil boom had caused an appreciation of the Venezuelan currency, similarly to the later 'Dutch Disease' concept".

by its turn hampered economic development. The Venezuelan economy became less competitive (Bastos, 2008). It was blocked by the natural resources curse, which is characterized by exchange rate overvaluation and low industrial competitiveness.<sup>9</sup>

In other words, exchange rate overvaluation was a mechanism of wealth distribution from the high productive oil sector. As a result, following Furtado ([1974] 2008, p. 74):

1. Exchange rate overvaluation in low productive countries tends to disarray important sectors. To circumvent it, they set high selective protection measures.
2. In general, activities that demand more protection are the ones already established, i.e., which produces consumption goods. In consequence, high-income classes, importers of durable consumption goods and investor who imports capital equipment take advantage from hidden subsidies derived from overvalued currency.
3. An appreciated currency combined with a high protection for consumption goods sector cause a high prices level – in comparison with international prices – and high monetary wages (in relation to productivity). Both are lower in competing countries.
4. High monetary wages along with external overvaluation (low prices of capital goods) generate a tendency to replace labor for capital. The bigger capital density of one industry or process, the more attractive is this capital for local investor.
5. The up surging propensity to save labor has, inter alia, the following outcomes: a) enlarges the productivity differences among sectors, b) wages growth gets slower than income from capital, c) sluggish occupational diversification and domestic market expansion.
6. From previous statements, it is reasonable to infer that benefits from the oil sector's high productivity tend to concentrate on consumers from high-income classes.
7. In 1974, the author came back to Venezuela to assess its economy *in loco*. In "Notes on Venezuelan economy and its current perspectives", Furtado (1974) reinforces his claim that exchange rate overvaluation and subsidies are detrimental to local production, "enlarging [...] structural labor surplus and depressing wages from poorer classes" (Furtado, 1974, p. 121). As a result, it would generate "[...] an economic system fundamentally ori-

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<sup>9</sup> It is important to point that the even the possibility of oil prices decreases in the 1950's was not capable of generating a currency crisis. Nonetheless, when it happened in the beginning of 2009, it causes a BP crisis similarly to those one from peripheral countries that do not export oil.

ented towards consumption and prodigality and in which income is too concentrated and may tend to concentrate permanently”<sup>10</sup> (Furtado, 1974, pp. 121-122).

According to Bastos (2008, p. 923), in Furtado’s paper from 1974, a frequent matter comes up in his work: association between luxury consumption and capital-intensive technology. This combination is amplified by the low cost of sophisticated capital goods and income inequality. Following Medeiros (2007, p. 92), the main difference is that in other countries, the foreign currency restriction boosts domestic production of industrial consumption and capital goods, whereas they were imported in Venezuela due to an appreciated currency, curbing domestic production.

In his paper, Furtado indicates different paths that the Venezuelan economy should follow to turn into a developed one. To this end, the first step should be the elaboration of a social project in order to frame an authentic development policy. The government would be responsible for its implementation. An action plan should focus on consumers as a means of changing their demand pattern, and on producers so that they become more integrated in the economic system, improve their internal economic control and set a minimum level of technology independence in most important sectors (Furtado, 1974, pp. 125-126).

To sum up, Furtado hinges an overview stressing the outcomes from an economy outlined by a non-diversified productive structure, high technology heterogeneity and high-diversified consumption of final goods, appreciated currency and low productivity. Without any meaningful change in these structures, underdevelopment would not be overcome.

## THE ROLE PLAYED BY EXCHANGE RATE IN *ECONOMIC GROWTH OF BRAZIL (EGB)*

*EGB* has five parts, starting from the Brazilian colonial period and covering through to the 20<sup>th</sup> century, more specifically until 1950. The role played by the exchange rate arises in chapter IV, at the first part of the book, called “Economic Bases of Territorial Occupation”. Nonetheless, it is more stressed, specifically in the fourth (The Economy of Transition to Paid Labour) and fifth (The Economy of Transition to an Industrial System) part of the book.

Coutinho (2008) highlights that Furtado divides his analysis into four categories: slavery versus paid work; monetary income versus non-monetary income; subsistence versus surplus production and dynamic sector (high productivity) versus subsistence sector. The main tool in Furtado’s economic analysis is expenditures

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<sup>10</sup> “[...] um sistema econômico-social fundamentalmente orientado para o consumo e o desperdício e no qual a renda é muito concentrada e provavelmente tende a se concentrar de forma permanente” (Furtado, 1974, pp. 121-122).

multiplier, which operates only in monetary transactions field.<sup>11</sup> Along with the multiplier effect, he combines the dynamics of relative prices (internal versus external) and the equilibrium between supply and demand.

One of the central elements in his analytical framework is the payment (monetary) of production factors. Once an economy based on primary exports and slavery regime does not use money as a means of transaction, monetary flows are not significant. In addition, access to foreign currency is satisfied by exportation. Subsequently, it is directly impacted by the exchange rate policy.

Exchange rate policy in *EGB* appears for the first time in chapter IV, discussing the disarray of the agriculture system in which the Brazilian colonization was settled. Furtado argues that the maximum profitability stage of the Portuguese agricultural-colonial system had been overdone.

He emphasized that Portugal supplied manufactures to Brazil. Some of them were produced by Portugal; others were imported from European countries and were priced in gold. Hence, income transfers due to exchange rate depreciation were particularly favorable to exporters from the metropolis. Thus, since colonial times, exchange rate changes favored the Portuguese metropolis and its upper social class.<sup>12</sup>

In the second part of the book – the slavery economy of tropical agriculture in chapter XII, Furtado discusses the growth of the subsistence sector in the north, south and northeastern areas in the 17<sup>th</sup> century and about the simultaneous decrease of exports as a share of colonial production. In addition, he shows that the metropolis needed to rearrange the economic system by repeated exchange rate devaluations.

From the perspective of the colony, it brought about some relief mainly for regions that exported sugar. But it also contributed to the aggravation of the economy in poorer regions, which had little or almost nothing to export and an inelastic import demand. Importation was limited to indispensable items such as salt. The rise in price of manufactured goods reached an extreme high that in impoverished areas such as Piratininga, a simple item of cloth made of imported fabric or a shotgun would cost more than a residential house. These factors helped to acutely reverse the ways of substance economy. It also contributed to the

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<sup>11</sup> Coutinho illustrates Furtado's analysis through sugar cane plantation model: i) all monetary income is concentrated on international trade, while domestic market transactions are non-monetary; ii) labor force is enslaved and therefore unpaid; iii) the main produce unit – sugar mill – is the high productive sector, while other activities are regarded as subsistence ones; iv) land is a free factor, or almost free, and capital (including slaves) is scarce; v) spend multiplier do not act because profits are used to import and there is not payment in national territory.

<sup>12</sup> Coutinho (2008) address this relation as follows: i) the Portuguese devaluated their exchange rate in order to increase sugar producer's profitability; ii) the colony did not benefits from devaluation, because it kept importing consumption goods at international prices.

fragmentation of the production unity system, disappearance of complex social relationships, replacement of general law to a local set of rules, etc. (Furtado, 1959 [1974], p. 69).<sup>13</sup>

This passage points out who were better off from exchange rate devaluations. The main impaired regions were those with less income. Clearly, the exporters, who represented the wealthy and powerful class, were benefited. Furthermore, there was a process of economic fragmentation and regional concentration at all levels (municipal, state and major regions). It presented important elements of the uneven and combined development, a corollary of the center-periphery scheme that Furtado himself disclosed.<sup>14</sup>

Coutinho (2008) notes that in this period there were already monetary flows denominated in a national currency. Consequently, there was monetary income not only concentrated in international transactions, but on the domestic market as well.

In the fourth part of the book, in chapter XVII, the author reveals important political events that took place in Europe by the end of 18<sup>th</sup> century. The occupation of the Portuguese kingdom by the French troops made the direct contact between the colony and accessible markets indispensable. In 1808, a decree implemented the “opening of the ports to friendly nations”. Thereafter, the treaties of 1810 conceded a privileged power to England, with extraterritorial rights and preferential tariffs. In 1822, the colony became independent from Portugal. In 1831, since Dom Pedro I lost his personal power, the dominant colonial class formed by affluent agricultural exporters ascended to power.

On one hand, revenues increased once Portugal did not intermediate transactions with England anymore. On the other hand, a tariff agreement with England, which would expire only in 1844, worsened fiscal conditions. To finance its expenses, the government issued paper money.

The current account imbalance along with the need to finance the central government<sup>15</sup> had an effect on real exchange rate. In an economy which the monetary income was small and with a high import coefficient, issuing money increased

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<sup>13</sup> “Do ponto de vista da colônia, tais desvalorizações, se traziam algum alívio à região exportadora de açúcar, também contribuía para agravar a situação das regiões mais pobres que pouco ou nada tinham para exportar e cuja procura de importações era altamente inelástica pelo fato mesmo de que se limitava a coisas imprescindíveis como o sal. O encarecimento das manufaturas importadas chegou a extremos e nas regiões mais pobres, como Piratininga, uma simples roupa de fazenda importada ou uma espingarda podiam valer mais que uma casa residencial. Esses fatores contribuía para a reversão cada vez mais acentuada a formas de economia de subsistência, fragmentação do sistema em unidades produtivas cada vez menores, desaparecimento das formas mais complexas de convivência social, substituição da lei geral pela norma local, etc.” (Furtado, 1959 [1974], p. 69).

<sup>14</sup> It is important to say that Trotsky introduced the idea of uneven and combined growth at the beginning of 20<sup>th</sup> century to stress the relationship between a dynamic developed sector and undeveloped ones in peripheral economies (see Mandel, 1980).

<sup>15</sup> The independence process brought about the financial need to afford military campaigns, which were funded by primary monetary issuing as well.



the prices of imported goods. As a result, there was a depreciation of the domestic currency. Therefore, the urban population faced higher prices for imported goods. At the same time, large agricultural producers, who had self-sufficiency systems, kept their purchase power and earned extra income due to devaluation (rising of exportable goods price).

In chapter XVIII, meanwhile, Brazilian coffee production was boosted (approximately from the second half of 19<sup>th</sup> century to 1920), and Furtado pointed out the mechanism by which coffee prices fluctuation were fixed and its effect on different social classes.

Correcting external imbalances [exchange rate devaluation] was meant to be the last resort, which led to transference of income from who paid for imported goods to those who sold exported ones. As importations were paid collectively by everyone, exporters were socializing losses, which the economic system tended to concentrate on their profits. It is true that this income transfer occurred among the business class who were at the same time exporters and consumers of imported goods. Nonetheless, the main part of such transfer occurred between the large number of consumers of imported goods and export businessmen (Furtado, 1959 [1974], p. 165).<sup>16</sup>

This passage advocates the thesis about socialization of losses through exchange rate devaluation when there was a decline in coffee international prices. When it happened, there was an external imbalance, so that exchange rate devaluation prevented a significant profit shrinkage from large coffee growers, keeping their income level. Nonetheless, at the same time, all social classes lost purchasing power due to the rise of import goods' prices.

When slavery ended by the second half of the 19<sup>th</sup> century, exchange rate dynamics changed completely. If the analysis was until then based on slavery, now it turned to paid work. This, by its turn, stimulated the monetary income (versus non-monetary income, which prevailed before).

In this context, payment (in currency) of producers' factors represented a breakdown in the former exports dynamics. It triggered the expenditure multiplier, enabling the transition from an agricultural to an industrial system. Nevertheless, large coffee growers kept their political power during Brazilian Second Reign until its First Republic.

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<sup>16</sup> “O processo de correção do desequilíbrio externo [desvalorização cambial] significava, em última instância, uma transferência de renda daqueles que pagavam as importações para aqueles que vendiam as exportações. Como as importações eram pagas pela coletividade em seu conjunto, os empresários exportadores estavam na realidade logrando socializar as perdas que os mecanismos econômicos tendiam a concentrar em seus lucros. É verdade que parte dessa transferência de renda se fazia dentro da própria classe empresarial, na sua qualidade dupla de exportadora e consumidora de artigos importados. Não obstante, a parte principal da transferência teria de realizar-se entre a grande massa de consumidores de artigos importados e os empresários exportadores” (Furtado, 1959 [1974], p. 165).

In the fifth part of the book – The Economy of Transition to an Industrial System (Twentieth Century) – in chapter XXXI, called “Defense Mechanisms in the 1929 Crisis”, Furtado shows the mechanisms that were implemented to avoid coffee prices falling in order to benefit the better-off coffee producers. The first was exchange rate devaluation, which burdened the public budget, which was partially compromised by external debt services, and prompted an undesirable price increases.<sup>17</sup>

In the face of a decrease in international coffee prices as well as in primary goods’ prices, which started by the end of 1929, a problem with supply and demand arose. In other words, although coffee prices plummeted, there was not enough demand to absorb the production. In contrast, since exchange rate devaluation fostered coffee crop harvest (increasing supply), it caused another round of prices’ fall and exchange rate depreciation, contributing to worsening the crisis. Hence, exchange rate devaluation was not an efficient mechanism to maintain coffee growers’ income (Furtado, 1959 [1974]).

The government adopted the following measures to keep coffee prices high: purchasing of excess coffee supply to maintain equilibrium between demand and supply and financing it through external loans (external imbalances were compensated by exchange rate depreciations, triggering the socialization of losses). The purchase of unsaleable coffee stock acted as an income multiplier, combined with the income generated by consumers and investors. However, buying unsaleable coffee did not augment the productive capacity.

At the same time, it stimulates investment in the domestic market. Thus, the dynamic economic center turned up to domestic consumer market. From now on, it was necessary to import capital goods to increase productivity.

Coffee prices’ control policy, associated with exchange rate devaluation, accidentally caused development in the industrial sector.<sup>18</sup> In the following passage, Furtado stresses the importance of the dichotomy between external versus internal prices.

Based on this new relative price level, new industries were created in order to replace importations [...] However, the recovery of exportation would have to bring, sooner or later, an adjustment of the exchange rate policy. [...]. Thus, improvement in exchange rate would have put more

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<sup>17</sup> In chapter XXVII, Furtado argued that primary-exporter countries have difficulties on following the gold standard principles. Their income generation were very dependent on primary exports. Thus, contraction of metallic reserves, which was the classical adjustment mechanism during crisis, should be very large compared to its economy and population size. Besides, it would be necessary to maintain large monetary reserves; otherwise, the economy would be subjected to external disequilibrium, which was transmitted to exchange rate fluctuations (Coutinho, 2008).

<sup>18</sup> The debate over industrialization during the First Republic is very controversial. Unlike Furtado, Pélaes (1968) suggested that export expansion led to the necessary conditions of industrialization (see Saes, 1989).

pressure on balance of payments, provoking a shift in the exchange rate movement [...] a floating exchange rate regime became unsustainable.

The competitiveness between internal goods were almost nonexistent in an economy typically based on exportation of raw material. The exchange rate fluctuation compressed the need to seek another sector [...]. Since the start of competitiveness between the two sectors, the exchange modification began to have repercussion far too serious to be abandoned to the contingencies of the moment. Therefore, one of the mechanism of a broad adjustment as well as an effective instrument for protecting the old colonial economy structure were lost (Furtado, 1959 [1974], p. 203).<sup>19</sup>

Therefore, the author advocates that dynamic center displacement engendered competition among importers and domestic producers. From now on, fixing the economic system by exchange rate devaluation would harm the former. Hence, the loss socialization method, which had lasted since colonial times, was not viable anymore.

On the one hand, exchange rate appreciation would prejudice Brazilian exporters; on the other hand, imports would become cheaper, worsening manufacturing sector conditions. To this extent, exporters and the domestic market raised against new exchange rate appreciation. Consequently, the government opted for a fixed exchange rate regime.

Furtado compared this policy, which lasted during wartime, to the coffee purchase policy. A fixed exchange rate preserved the monetary income level as well as the purchase of unsaleable coffee. However, at this stage, there were coffee buyers, who bought it through credit, i.e. purchase power was generated inside the economy without the counterpart of goods and services supply. Therefore, there is a difference between both periods. In the former, the purchase power replaced the one associated with external demand fall due to high coffee prices level. It acted as a way of preventing a decrease in installed capacity utilization. In the latter, productive capacity connected to the domestic market had already been employed, so that

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<sup>19</sup> “Com base nesse novo nível de preços relativos, desenvolveram-se as indústrias destinadas a substituir importações [...] Ocorre, porém, que a recuperação do setor exportador teria que trazer mais cedo ou mais tarde uma modificação da situação cambial [...]. Assim, a melhora da situação cambial, ao provocar um brusco aumento das importações, criaria nova pressão sobre a balança de pagamentos, invertendo-se o movimento da taxa de câmbio [...] tornava impraticável o funcionamento de um sistema cambial com taxa flutuante.

Na economia tipicamente exportadora de matérias-primas a concorrência entre produtores internos era quase inexistente. As flutuações na taxa cambial comprimiam a procura de um ou de outro setor [...] Ao começar a concorrer os dois setores, as modificações cambiais passaram a ter repercussões demasiado sérias para que fossem abandonadas às contingências do momento. Perdia, assim, um dos mecanismos de ajuste mais amplos de que dispunha a economia e ao mesmo tempo um dos instrumentos mais efetivos de defesa da velha estrutura econômica com raízes coloniais (Furtado, [1959 [1974], p. 203)”.

fixing the exchange rate level augmented the exporter sector's income, when supply of imported goods were reduced, pushing up domestic prices.

Therefore, after the end of World War II, imports liberalization stimulated demand for imported goods that higher than the Brazilian capacity. This disequilibrium could be compensated for by exchange rate devaluation or through a selective importation control. They chose the second one, since authorities believed that rising prices would foster social disorder, which was already on the rise.

This policy benefits the industrial sector even more.

On the one hand, due to the possibility of significantly reducing external competition through importation control; on the other hand, because of the relative low prices of raw material and equipment (Furtado, 1959 [1974], p. 218).<sup>20</sup>

After the ending of World War II, although not intentionally, the exchange rate policy stirred investments in the domestic market produce, particularly the industrial sector. Nonetheless, Furtado argues that such policy cannot be interpreted as a way of redistributing income from export sector to the sector linked to domestic market. One reason is that good export prices displayed a positive trend. Another reason is that buying new machines increased overall economy productivity, improving investment opportunities.

To sum up, the analyses of exchange rate policy in *EGB* show a distributive conflict. It also argues that this policy acted as way of protecting/benefiting the more powerful economic and political sectors. Firstly (before the 1929 crash), they managed the exchange rate policy in order to serve the preferences of exporters (coffee producers). When coffee prices were on the rise, exports grew and the exchange rate tended to appreciate. In this case, coffee producers (exporters) worked to set a fixed exchange rate level so that it did not reduce their profits. When coffee prices were falling, they forced exchange rate devaluation. Consequently, prices rose and wage earners lost purchasing power. That was the loss socialization mechanism, in which coffee producers sustained their gains. That is, in both situations, exchange rate manipulation assured their exporter's profitability. After the Great Depression, the industrial sector became a more important player. Hence, the government controlled the exchange rate to protect this sector. On the one hand, they needed an appreciated currency to buy inputs and capital goods; on the other hand, they needed to be protected against imported goods competition. In this context, the government set an exchange rate control regime and, subsequently, the regime of multiple exchange rates.

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<sup>20</sup> "Por um lado, porque a possibilidade de concorrência externa se reduzia ao mínimo através do controle das importações; por outro, porque as matérias-primas e os equipamentos podiam ser adquiridos a preços relativamente baixos" Furtado.

## CONCLUDING REMARKS AND PERSPECTIVES ON THE CURRENT DEBATE

When analyzing the Venezuela situation, Furtado connects the exchange rate issue to structural change, which is a theme recently recaptured by the literature. In *EGB*, the author stresses how exchange rate policy has moved in line with preferences of the most powerful class since colonial times. That is, the socialization of losses method, implemented by exchange rate policy, lasted for a long while. Furthermore, his work reveals that there are structural issues guiding economy policy, which are much more important than the conjectural ones. Thus, exchange rate policy does not strictly follow macroeconomic variables, but represents the synthesis of class conflict. It takes into account elements of political economy, which should be considered in a historical approach.

Furtado's contributions in relation to exchange rate policy are both original and actual. Recently, particularly in the last decade, this topic recurred in the current debate. Nevertheless, there are few papers discussing the relation between exchange rate policy and class conflict. These views have not yet been incorporated into current analysis. According to Furtado, these are key issues to understanding development matters.

Concerning the current Brazilian debate, there are two main questions in relation to exchange rate policy: i) it is necessary to understand how an appreciation exchange rate policy benefits different social classes and how it shapes the growth strategy pattern; and ii) the academy needs to broaden and deepen discussion on this topic.

Following Amico and Fiorito (2013), we identified at least two growth strategies (not necessarily new) under dispute in Brazil. The first refers to the growth strategy led by the financial and primary sector, based on financial deregulation and trade integration through primary exporters. Invariably, this option is accompanied by exchange rate appreciation.

From the 1990s onward, exchange rate appreciation has played a dual role: it prevented inflation pressures and increased real wages. In other words, exchange rate appreciation, which lasted for a relatively long period, helped inflation control as well as weakened urban workers-capitalists conflict, since real wages rose and allowed for the consumption of imported goods. To a certain extent, this exchange rate policy depends upon a positive (and significant) difference between a domestic and external interest rate. Furthermore, a high interest rate helps to control inflation. Nonetheless, exchange rate appreciation increases wage costs in dollars, so that domestic production lost competitiveness. Consequently, it now depends on the increase of productivity in the export sector or nominal wage reductions. In Brazil, since wage rigidity is high, this strategy hampers exchange rate devaluation, which, combined with a high interest rate; prevents a sustained growth of aggregate demand. The economy is stuck in a low growth trap, relying on external capital flows and prices commodity cycles.

An alternative strategy, called "industrial developmentalism", is based on com-

petitive exchange rates. There is a lower degree of financial deregulation (and capital controls can be used to diminish financial openness), in order to keep a competitive and stable real exchange rate. In this sense, exchange rate dynamics do not depend only on interest rate policy. Authorities keep policies to maintain a competitive real exchange rate instead of raising the interest rate to stimulate capital inflows. On the one hand, these devaluations diminish wage costs measured in dollars and increase employment in export sector. On the other hand, it raises wage goods prices, having a negative impact on real wages. In this context, it is possible that workers demand better nominal wages, pushing up inflation. The challenge is to conciliate policies that enhance growth, but at the same time put pressures on inflation, which increases workers' dissatisfaction.

Due to inflation memory and exchange rate populism, after the 1994 stabilization, the Brazilian Central Bank has been complacent with exchange rate appreciation. Although this strategy helped to control inflation, it caused industrial employment to fall and the substitution of domestic production by import goods. In the long run, it can generate a vicious cycle, leading to external constraints, abrupt nominal exchange rate devaluation, inflationary spiral, depression of real wages and new distributive conflicts.

Furtado ([1959] 1974) and Bresser-Pereira (2010), among others, argue that exchange rate policy is a political issue. Nevertheless, academic literature (particularly in Brazil) does not give enough emphasis to political matters underlying exchange rate policy. By doing so, the debate concentrates on possible effects of exchange rate policy on growth (the same applies to international literature). However, who would benefit from this policy? Which are the pros and cons of such policy? These questions ought to be answered from a political economy approach. Then they can shed some light on the current debate.

In other words, economic growth through exchange rate policy is not only a technical decision of bureaucracy. When the underlying class conflict is neglected, the new theoretical models are distanced from reality and turn up into prescriptive policies. It is not enough to debate the relationship between exchange rate and economic growth. The current debate must debate compensatory mechanisms, which balances interclass and intraclass distributional conflicts.

Hence, we conclude that it is necessary to deepen analyses on the current debate on Brazilian exchange rate policy. It is necessary to present to society the costs and benefits of a sustainable growth policy, which may require sacrificing the present for a better future. Even though it causes income and wages losses in the short run due to exchange rate devaluation, export-oriented industrialization is important to stimulate growth and employment. It should be implemented by the government. In this sense, we agree with Furtado, who highlights the inertial behavior of the Brazilian state and the absence of deeper thought about such issue. According to him, as recorded in an interview (*Jornal da Unicamp*, 2004): “*Nowadays, the state is absent owing to global conjuncture, besides being subject to many interests. In my opinion, the most serious problem is exchange rate manipulation. I believe that exchange rate*

*management is fundamental to implement an effective policy. Today we can't even talk about it. There is neither will to debate nor courage from politicians".<sup>21</sup>*

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<sup>21</sup> "Estamos numa época em que o Estado é omissor por conta da conjuntura global, além de estar submetido a muitos interesses. O que é grave, na minha opinião, é a manipulação da taxa de câmbio. Creio que o controle cambial é fundamental para se ter uma política efetiva. Hoje não se pode sequer falar disso. Não há margem para discussão nem coragem da classe política" (Furtado, 2004).

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