



Can poor institutions explain Brazil's economic stagnation? A brief review of policy choices and incentives

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ABSTRACT

This article critically examines Brazil's economic stagnation since the 1980s, contesting the overarching view that attributes underdevelopment primarily to poor institutions. While acknowledging Brazil's impressive growth from 1932 to 1980, driven by an entrepreneurial state, the paper argues that the institutional determinants of growth do not offer a plausible explanation for its slowdown. Instead, it presents an alternative perspective rooted in New Developmentalism and structuralist economics, highlighting the detrimental impact of policy shifts initiated in the 1980s. These include the retreat of the developmental state, a decline in public investment, chronically high interest rates, and a persistently overvalued exchange rate, all of which have hampered Brazil's structural transformation. Knowing who benefits and who loses from these policies provides insight into why policymakers persist on this stagnant path, sacrificing sustained growth for momentary gains. It concludes by asserting that policymakers have conveniently used the discourse of public inefficiency to justify withdrawing the government from its role in development. It advocates for a paradigm shift in policymaking, urging recognition that poor institutions are primarily a consequence, not a cause, of underdevelopment.

1. Introduction

Between 1932 and 1980, Brazil experienced its fastest growth period in history, registering the world's third-highest average GDP per capita growth, surpassed only by Japan and Russia (MPD, 2024). The debt crisis of the 1980s, triggered by external interest rate hikes and oil price shocks, marked a turning point in Brazil's catching-up trajectory—its GDP per capita, PPP, grew faster (i.e. it caught up) than that of the United States between 1932 and 1980, but slower (i.e. it fell behind) in the subsequent 42 years. Brazil's growth stagnation is not an exception among countries that have reached a similar level of development.

The term 'middle-income trap', coined by Gill and Kharas (2007), quickly gained popularity among academics and policymakers to describe middle-income countries caught in a structural condition of underdevelopment. The definition of the trap is fuzzy, with empirical studies proposing different income thresholds and measures of growth slowdown. For instance, Eichengreen et al. (2014) identify two growth slowdowns associated with entrapped countries: around \$10,000–\$11,000 and around \$15,000–\$16,000 (2005 US Dollars, PPP); whilst Felipe et al. (2012) do not consider this second threshold, as they view this level of GDP per capita as high-income. According to their criteria, Argentina, Chile, and Uruguay are not classified as entrapped countries.

Brazil is an entrapped country by any measure.

Authors associated with middle-income trap literature have consistently highlighted the role of institutions in development, asserting that poor-quality and inefficient institutions severely hinder the growth of developing countries. This article argues that the institutional determinants of growth do not provide a plausible explanation for Brazil's stagnation. Furthermore, policy recommendations stemming from this literature, such as the need to improve public education and curb corruption, tend to be commonsensical and not specific to middle-income countries. Conversely, other propositions, such as the need to reduce the clientelist culture, are impractical, given that policymakers do not have readily available policy levers to enact the required change.

The argument is presented in three sections. The first section provides a brief overview of Brazil's rapid growth period, which drove the country from a low-income to an upper-middle-income status, highlighting the role played by Brazil's entrepreneurial government during this period. The second subchapter discusses Brazil's stagnation from the perspective of authors associated with the concept of the middle-income trap. The central arguments and policy recommendations presented by these authors emphasise an institutional economics view of development, which, although grounded in reality, does not offer an attainable path for Brazil to move out of the trap.

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The third section presents an alternative view, chiefly articulated by New Developmentalism and structuralist authors. This perspective emphasises the macroeconomic and microeconomic policy levers Brazil has moved since its sudden stop in the early 1980s. It draws from the empirical literature demonstrating how Brazil's macroeconomic disequilibrium and the demise of its entrepreneurial state hampered Brazil's economic growth and its firms' international competitiveness. Lastly, the section briefly examines some of the short-term motivations behind the policy choice to continue pursuing this set of policies.

The final section discusses how policymakers in Brazil conveniently adopted this institutional view of development to justify withdrawing public institutions from their role in the country's development. It notes that policymakers have operated with a subset of policy levers, which excludes developmentalist policies under the false assumption that the government is incapable of efficient resource allocation. Discerning who benefits and who loses from this strategy provides insight into the incentives driving policymaking and highlights how the institutions have, in fact, worked exceptionally well for their winners. It ends by asserting that the reemergence of an active entrepreneurial state in Brazil, capable of fostering long-term growth, seems unlikely as long as weak institutions are still presented as the cause, rather than the consequence, of underdevelopment.

2. Brazil 1913–1980: Moving from a low- to high-middle-income

Celso Furtado (1964), writing at the end of the first globalisation wave, noted that the economic connections between the world's capitalist nucleus and peripheral economies typically resulted in hybrid economies in the global South. Globalisation shaped those countries' economic structure into two sectors: a large subsistence/low productivity sector and a small extractive capitalistic nucleus. Hybrid economies began emerging during Europe's forty-fold increase in trade volume between 1840 and 1913, when developing countries joined international trade as raw materials suppliers. Despite limited improvement in living standards, derived from the shift of labour from the subsistence sector into the small capitalist nucleus, the increase in global demand for raw materials went almost unnoticed by most of the

population in developing countries in this period. Trade volumes were generally too low for exports to act as a dynamic element in economic growth in developing countries, as was the case in Brazil during this period (Hanson, 1986/1996).

During the years following World War I, developing countries with a more favourable set of production factors led a structural transformation from the two-structure hybrid economies into an economic structure characteristic of middle-income countries. Those countries, including Brazil, developed export sectors capable of generating a mass of income sufficiently large for exports to impact their growth trajectories. In Brazil's case, active governmental intervention, land availability and the elastic labour supply allowed its coffee sector to maintain a long period of growth and become the dynamic element that kick-started the structural transformation that elevated the country from low- to upper-middle income. Between 1918 and 1980, Brazil reduced its per capita income gap with the United States by 18 p.p. – Brazil's per capita income in 1918 was USD 1,041 (in 2011 values, PPP adjusted) or 10 % of that in the United States. By 1980, its GDP per capita reached USD 8,249, or 28 % of that of the United States. As presented in Figure 1, Brazil has not closed the gap since the early 1980s.

The country began its structural transformation from a hybrid economy into a middle-income structure during the second coffee cycle (1919–1929). In this period, Brazil consolidated its light industry, with the emergence of its first steel production industries, machine and electric motor manufacturers, and the cement industry (Mello & Tavares, 1985/2023). Between 1913 and 1929, coffee production grew by 70 %, with steady export growth and a consistently high income secured through high levels of governmental interventions in the economy. The government's strategy included a set of interventionist policies, such as state-controlled stocks, export and production quotas, transportation permits, low-interest loans to the sector, and a fund to purchase and limit supply whenever necessary. Additionally, the government led a 20 % current devaluation in 1926, followed by a currency stabilisation fund blocking exchange rate appreciation (Mello & Tavares, 1985/2023). Those policies allowed the export sector to retain elevated income levels and maintain a mass of wages that, albeit low on average, was high enough to prompt a change in consumption habits

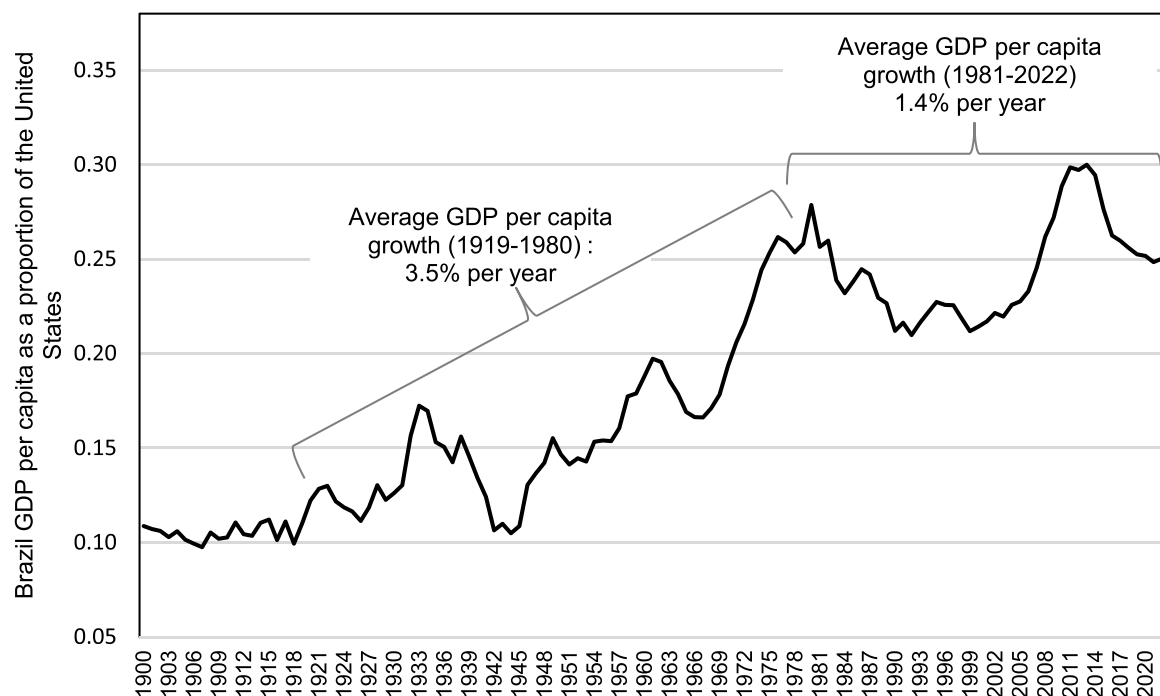


Fig. 1. Brazil's GDP Per Capita as a proportion of the United States, 1900–2022.

Note. US Dollars, constant 2011 values, PPP adjusted—data from Maddison Project Database (MPD, 2024).

initially supplied via imported goods.

The 1929 crisis provoked an exchange rate depreciation in developing countries while severely impacting the global North's demand for raw materials. To reduce the pressure on its balance of payments, the government implemented stricter import rules and quotas during the 1930s, favouring local manufacturers and accelerating the import substitution process. In Brazil, where internal demand remained heated due to the maintenance of coffee price valorisation policies, the import reduction positively impacted the industrial nucleus, contributing to economic growth from 1929 to 1939 (Feijó, 2024). Despite the low growth rate during the first years of World War II, which faltered to less than 1 % between 1939 and 1942 (Fishlow & Filho, 2020), a renewed interventionist cycle allowed the country to establish its heavy industrial base and continue its structural transformation. The implementation of the state-owned Companhia Siderúrgica Nacional steel plant in Volta Redonda in 1942, formed through a governmental agreement with the United States, marks the beginning of this phase (Fishlow & Filho, 2020). Brazil's entrepreneurial state investments in the early 1940s also included the foundation of Companhia Vale do Rio Doce and Fábrica Nacional de Motores.

The country's industrialisation continued in the post-war period, including under the term of President Dutra, which adopted contractionist fiscal and monetary policies but never ceased to manage the exchange rate and enforce strict import quotas (Feijó, 2024). During the 1950s and 1960s, Brazil's central government doubled down on its import substitution strategy. It increased economic interventionism, implementing protectionist limits on imports, providing credit to private enterprises, building a developmental state structure, and investing in state-owned industrial diversification. The National Council for Scientific and Technological Development (CNPq), National Bank for Economic Development (BNDES), and Petrobras were all founded in the early 1950s. Industrial output grew from 11.5 % of Brazil's GDP in 1929 to 23.1 % in 1957, and its GDP per capita more than doubled in the same period (Furtado, 1970/2003; Ipeadata, 2024).

By the early 1960s, Brazil's structural transformation into a three-sector economy, characteristic of a higher stage of underdevelopment, had been largely completed. The country's industry manufactured 90 % of all products consumed locally; in some sectors, such as consumer durables, local industries accounted for as much as 95 % of all domestic supply (Furtado, 1970/2003). Between 1919 and the 1960s, Brazil developed a diversified industrial nucleus capable of producing its own capital goods and, considering the most conservative estimates by Bacha et al. (2023), Brazil's GDP per capita grew by 4 %/year between 1900-1947, and 6.2 %/year between 1947-1980, which is at least four times higher than the less than 1.4 % GDP per capita growth registered since (MPD, 2024). The structural transformation had a significant impact on the population, reducing the development gap with developed countries. Considering the multi-dimensional development gap proposed by Paprotny (2021), which includes variables beyond GDP per capita, Brazil managed to reduce its time lag with developed economies from above 50 years to between 25 and 50 years, where it remains.

3. Poor institutions and the middle-income trap

The term 'middle-income trap' first appeared in Gill & Kharas' book on East Asia published in 2007, based on the authors' experiences working for the World Bank in the region. It referred to the difficulty they faced in understanding which sort of growth strategy would work for the middle-income economies in the region (Gill & Kharas, 2015). The middle-income trap literature that has emerged since emphasises a set of causes for the middle-income trap, which can be summarised as:

- a. Poor basic and advanced infrastructure: Trapped countries lack good basic infrastructure (e.g. roads, ports, electricity) and advanced infrastructure (e.g. high-speed communication networks, installed computing capacity) (Agénor & Dihn, 2013; Agénor & Canuto, 2015; Agénor, 2017). Gill and Kharas (2015) mention the infrastructure of urban areas in particular, highlighting how the low-liveability cities of middle-income countries hinder skilled labour pooling.
- b. Lack of access to finance: Firms in middle-income countries have constraints in accessing the finance necessary to fund their investments. Developing country firms have no credit available, with conditions that are not conducive for innovations, and intermediation costs are often too high due to elevated monitoring costs (Agénor & Canuto, 2015; Agénor, 2017).
- c. High inequality and low educational attainment: Persistent, or worsening, inequality in middle-income countries can constraint growth by affecting the access to finance to a large part of the population and by serving as a disincentive for the poor to acquire new skills (Egawa, 2013; Agénor, 2017; Wang & Lan, 2017).
- d. Lack of sound legal and governmental institutions: Middle-income countries do not have the institutional structure to control corruption, advance accountability, and enforce contract rights (Agénor & Canuto, 2015; Gill & Kharas, 2015; Agénor, 2017).

Based on the institutional barriers to development presented, the policy recommendations for trapped countries—namely, improving public services, governance, and accountability, increasing educational attainment, and reducing corruption and inequality—are not distinct from what is expected of any competent government at any level of development. Moreover, the lower quality of institutions observed is a fact of underdevelopment, not its cause. Middle-income countries cannot afford the same level of educational systems and rule of law as developed countries. Total public expenditure per full-time student in Brazil, from primary to tertiary education, was USD 2,865 in 2021, about a third of the OECD's average expenditure of USD 10,929 per full-time student in the same year (PPP, constant 2015 values) – even though Brazil has consistently spent a higher proportion of its GDP in education. Figure 2 compares Brazil's public investments in education as a % of GDP and as PPP-adjusted dollar values.

The same analysis applies to public order and safety expenditures; Brazil has consistently devoted a higher percentage of GDP to law enforcement, with around 3 % of GDP devoted to courts, police forces, the prison system, and ancillary public safety activities – OECD countries directed on average 1.7 % of GDP to law and order. Nonetheless, the per capita expenditure (USD, PPP) in OECD countries remains 75 % higher than in Brazil. Figure 3 shows the positive difference between Brazil's and the OECD average law and order expenditure per capita and as a % of GDP.

Brazil's low investment in public institutions, relative to developed nations, is a tautology: it is lower because Brazil's per capita GDP is lower than that of developed economies. Unquestionably, Brazil would benefit from a better set of institutional interests, more equality, and better allocation of public funds. However, it is wishful thinking to believe that better allocation alone would compensate for the difference in the amount of funds available per citizen. Assuming Brazil has the same efficiency per dollar spent as the average OECD country, every dollar invested per student in Brazil would have to be 2.75 times more efficient to match the PPP expenditure. Historically, the superior institutions of developed countries resulted from economic growth, with countries improving the rules of the game as they became increasingly capable of affording better institutions. Taking a historical-deductive perspective of development, Chang (2002; 2011) finds that the developmental policies adopted by developed countries – namely, targeted state action with public-led trade, industrial, and macroeconomic developmental policies – were prerequisites to building better institutions. Developed countries developed better institutions as they got richer, not the inverse.

Acemoglu, Johnson, and Robinson (2001) propose a slightly different reasoning based on a historical view of institutional development. Working with the mortality rate of settlers in the 17th, 18th, and 19th centuries as an instrument for the type of colonisation policies and,

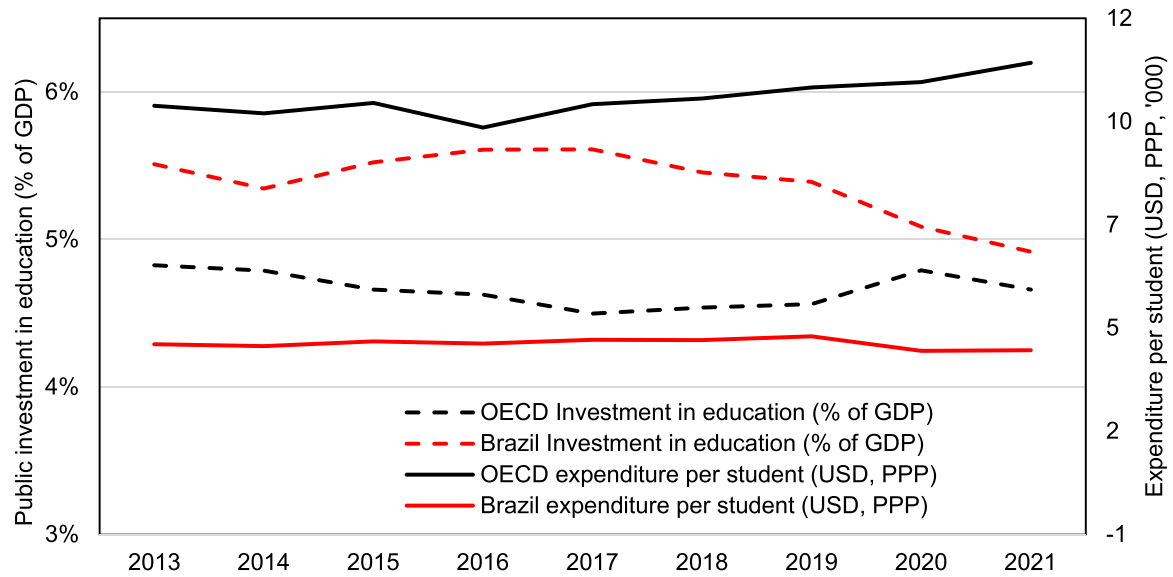


Fig. 2. Expenditure in Education, as a % of GDP and total value per student.

Notes. Government expenditure in education as a % of GDP. Expenditure per Student in US dollars, PPP converted, Constant prices, 2015, from primary to tertiary education. Data from [OECD \(2024a\)](#).

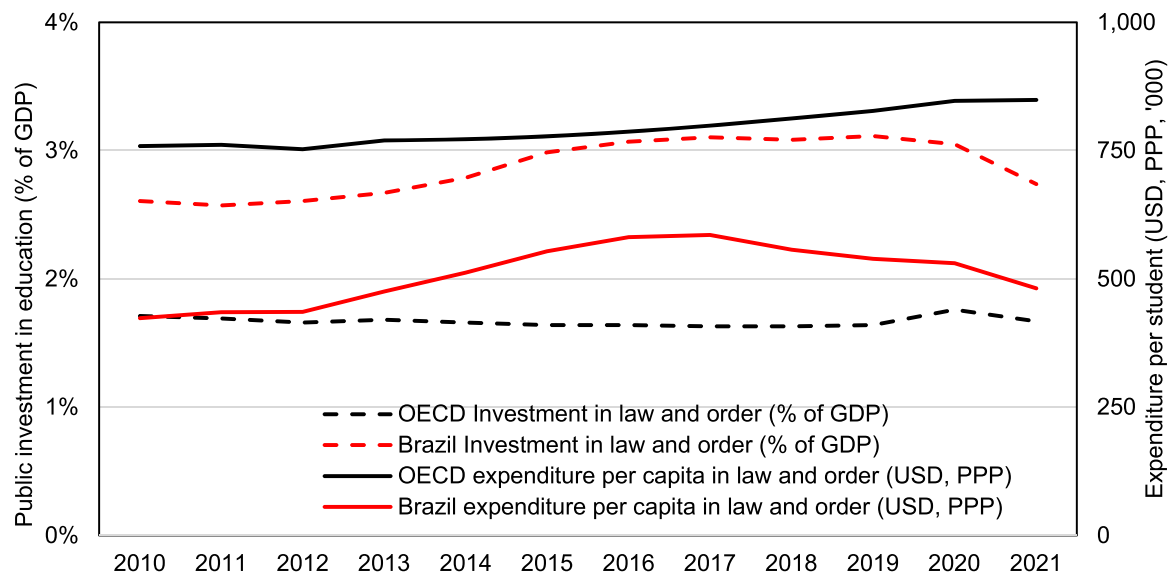


Fig. 3. Law and order expenditure per capita and as a % of GDP, Brazil and OECD.

Notes. Own elaboration based on [OECD \(2024b\)](#) and Tesouro Nacional (2024).

thus, investment in institutions and institutional quality in the colonies. The authors find that settler mortality is a valid instrument for schooling and, therefore, for growth, given the significant correlation between schooling and growth. They propose that areas with lower settler mortality rates, where colonisers replicated European institutions¹, achieved better growth results, with the difference in institutions explaining

three-quarters of the income per capita difference across former colonies.

Nonetheless, the legacy of lower-quality institutions was also a reality in Brazil during rapid economic growth between 1919 and 1980. As logically reasoned by [Bresser-Pereira et al. \(2020a\)](#), this was not a new phenomenon at the time of the slowdown, so it is cannot offer a plausible explanation for Brazil's slowdown after the debt crisis of the early 1980s. The country had a satisfactory growth rate until it experienced a sudden stop; logically, the explanation for the slowdown must lie in a new endogenous or exogenous factor ([Bresser-Pereira et al., 2020a](#)).

[Acemoglu and Robinson \(2010\)](#), presenting a case study of Latin American growth turn post-debt crisis, hint at a policy change that coincides with the sudden stop: "Policy reforms that took place in the late 1980s and 1990s included deregulation of the trade regime and severe cuts in tariffs, privatisation, and financial deregulation" (p. 146). To the authors, this policy shift was also the result of weak institutions, which

¹ A different critique of [Acemoglu et al. \(2010\)](#) may also be articulated from a different field. Anthropologist David Graeber and archaeologist David Wengrow present evidence contradicting the very premise of their study. From this perspective, [Acemoglu et al. \(2010\)](#) research is based on a flawed idea of superior European institutions; as [Graeber and Wengrow \(2021\)](#) put in *The Dawn of Everything*: "We like to tell ourselves that Europeans introduced the Americas not just these agents of destruction but also to modern industrial democracy, ingredients that were nowhere to be found there, not even in the embryo", a myth that the authors debunk in the book.

were the actual culprits, as the countries took this turn because “politicians realised that the policies of neoliberalism could be manipulated to fulfil clientelist interests” (p. 147). It follows as a policy recommendation that these countries should act to get rid of clientelist interests.

Clientelism is a fact of politics in Brazil and developed countries. Not only is it a stretch to define the United States’ revolving door politics as less clientelist than Brazil’s, but it is also unlikely that politicians serving clientelist agendas would act against their interests, reducing the practicality of this policy proposition. Changes to reduce clientelist culture will, at best, be incremental and implemented over the long term, given that no policy levers are available to promote the necessary cultural change.

A more pragmatic approach is to examine Brazil’s reforms since the 1980s and identify which policy levers were manipulated to feed this clientelist behaviour. Unlike colonialism and clientelism, these reforms were new to the country at the time of the slowdown, thus offering a plausible macro-structural explanation for the trap. The following section provides a brief overview of a different viewpoint on the middle-income trap. It highlights the policy options available to Brazilian policymakers, which are conveniently overlooked due to the prevailing assumption that Brazil’s institutions are too poor to play an entrepreneurial role and boost economic growth.

4. Policy levers associated with the middle-income trap

Felipe et al. (2012) suggest that upper-middle-income countries must maintain an average growth rate above 3.5 % for 14 years to escape the middle-income trap; Brazil’s growth rate has remained significantly below the required growth since 1981. As presented in Table 1, the strong growth rate that the country presented between 1932 and 1980, consistently above 3.5 %, has dwindled to less than half, with an average growth of 1.4 % in the subsequent 42 years between 1981 and 2022.

The following paragraphs summarise the policy changes introduced during the period, with empirical evidence of how the liberalisation reforms that began in the 1980s have hampered Brazil’s international competitiveness and severely impacted its ability to grow. While the 1982 crisis marks a turning point in economic growth, the movement away from a developmental state had started decades earlier – most evidently with the 1964 military coup, when the National-Developmentalist Pact that existed since the 1930s ended and was replaced by a “Bureaucratic-Authoritarian Pact” (Bresser-Pereira, 2009, p. 24). Bresser-Pereira (2009) distinguishes the first phase of the developmental state’s demise, which aimed for a needed fiscal adjustment and was rightly concerned with the current account, from the second phase, which started in the 1990s and had more pernicious elements hampering economic growth.

By the late 1970s, after a decade of growth based on externally funded public deficits, the need to implement policy corrections to reduce economic imbalances was evident (Bresser-Pereira, 1990). During the 1970s, the volume of Latin America’s bank debt increased by almost 30 % annually, with countries borrowing from the international banking system in foreign currencies and a prevalence of short-term

debt (Devlin and Ffrench-Davis, 1995). As the global situation changed, in the face of increased global inflation, bank real interest rates on Latin American debt rose to around 20 % by 1981–82, accompanied by a deterioration in the continent’s terms of trade (Devlin and Ffrench-Davis, 1995). Brazil began its adjustment in 1981, with interest rates on working capital increasing to 23 % and a reduction in credit advanced by banks; Banco do Brasil’s credit was reduced by 20 % in real terms in that year alone (Dalto, 2008). Additionally, public expenditures were subject to a ceiling, which impacted public investment – the total amount of investments by BNDES (National Development Bank), for example, was reduced by 21 % from 1979 to 1980 and then again by 22 % from 1980 to 1981 (BNDES, 1981).

Brazil began negotiating agreements with its creditors after Mexico defaulted on its external debt in 1982. International banks were over-exposed to Latin America, “the nine leading United States banks registered a loan/capital coefficient of 180 % in 1982: 50 % in Mexico, 46 % in Brazil, 26 % in Venezuela, 21 % in Argentina, 12 % in Chile” (Devlin & Ffrench-Davis, 1995, p. 428). Thus, the negotiations between creditors and the Brazilian government were guided by two principles: first, negotiations should conclude quickly to avoid new default declarations; second, the deal should make Brazil an exemplary case, ensuring it services its debt in full (Dalto, 2019). In its 1983 letter of intentions to the IMF, the Brazilian government doubled down on its austerity measures, committing to correcting economic distortions, eliminating subsidies, and withdrawing any intervention in the economy (Galveas & Langoni, 1983).

Part of the reforms implemented during the 1980s rightly targeted the correction of economic distortions ingrained in the economy. Some distortions were attributed to the maintenance of import substitution policies throughout the 1970s; the growth strategy based on external indebtedness resulted in economic imbalances that required correction (Bresser-Pereira, 2009). Nonetheless, the crisis that ensued was severe, and, overall, the remedies adopted in the 1980s proved ineffective. Inflation increased to above 400 %/year between 1988 and 1994, co-existing with an economic recession – a reality at odds with the proposition of demand-led inflation, which was only solved with the heterodox ‘Real Plan’ proposed based on the inertial inflation theory (see Bresser-Pereira, 1996). The shock treatment imposed by the reforms was mostly ineffective, but it succeeded in two areas: (a) it reduced the current account deficit, and (b) it ensured a continuous money transfer to foreign creditors. Between 1981 and 1989, financial transfers to creditors abroad accounted for an average of 2.7 % of Brazil’s GDP per year, despite a concurrent increase in total external public debt (Dalto, 2019).

The fiscal squeeze, linked to debt servicing and austerity measures, resulted in a collapse of public investment and a retreat of the developmental state. Subsequent fiscal and inflationary crises left little room for industrial policy, and Brazil reversed its industrialisation drive (Ocampo & Porcile, 2020). While some policy changes adopted in the early 1980s had merit in correcting imbalances, the laissez-faire stance towards government-led development has endured past the needed adjustment and inflation stabilisation. Brazil have persisted in the low governmental intervention direction, with little to zero industrial policy during the 1990s, 2000s, and 2010s, in stark contrast with the path of fast-growing Asian economies, including Japan (Akamatsu, 1962; Johnson, 1982), South Korea (Amsden, 1992; Lee, 2018), Taiwan (Wade, 1990), and, more recently, China (Lin, 2017).

The comparative perspective on public investment and the level of state entrepreneurship sheds light on one of the industrial policies Brazil changed since the 1980s. Public sector investment averaged 3.3 % of GDP between 1990 and 2023, significantly below the 5.9 % registered from 1947 to 1989 (IBRE, 2024). It also defunded its industrial policy mechanisms – taking development banks as an example, Brazil’s total assets in those banks accounted for 8 % of GDP in 2022, compared to 27 % in China, 30 % in South Korea, or 29 % in Germany (Xu et al., 2021). Contrary to the neoclassical prognosis, private sector investment did not

Table 1

Average yearly GDP per capita growth rate from 1932 to 2022, constant USD (%).

	1932-1961	1962-1980	1981-1994	1994-2022
Brazil	3.59	4.54	0.40	2.08
Latin America	2.53	2.81	0.76	1.84
China	0.71	4.38	4.87	6.07
South Korea	2.91	7.31	7.99	3.26
Southeast Asia	1.43	3.06	3.93	3.35
South Asia	-0.12	1.13	2.93	4.58

Notes. Latin America: Argentina, Chile, Colombia, Peru, Mexico. Southeast Asia: Indonesia, Thailand, Vietnam, Malaysia, and the Philippines. South Asia: India and Bangladesh. MPD (2024)

crowd in even after inflation stabilised, and total investment declined steadily as a percentage of GDP. Since the 1980s, Brazil has consistently ranked among the countries with the lowest investment levels; Figure 4 provides a comparative perspective of the total investment in Brazil and Asian countries.

Policy reforms during the 1980s and the retreat of the developmental state were the early stages of Brazil's current ineffective growth model. The more pernicious elements emerged only in the 1990s when policies associated with the conventional orthodoxy substituted the first Washington Consensus drive of the 1980s. Since the 1990s, Brazil has adopted a growth cum foreign savings strategy, with perennially high interest rates and a chronically overvalued exchange rate (Bresser-Pereira, 2009). From this perspective, chiefly articulated by the New Developmentalism (Bresser-Pereira, 2006, 2011; Marconi, 2012; Bresser-Pereira et al., 2014), the combination of high interest rates with non-neutralised Dutch disease has put its manufacturing industry at a significant international disadvantage, placing a constraint on structural change and economic growth.

The empirical literature on the growth rate of developing countries has demonstrated the 'light-switch' character of the exchange rate, as proposed by New Developmentalism (Bresser-Pereira, 2012). Investment in the productive sector and the current account equilibrium are conditioned on a competitive exchange rate, particularly for developing countries. Rodrik (2008), using panel data from 188 countries between 1950 and 2004, demonstrated the causal relationship between a competitive exchange rate and economic growth. The study complements Rodrik's (1986) article, which proposed the competitive exchange-rate policy as a tool for developing countries to promote structural change and increase welfare. Hausmann et al. (2005) demonstrated a correlation between exchange rate depreciation and the acceleration of economic growth. In a study with a panel of 43 countries between 1995 and 2014, Marconi et al. (2021) demonstrated the positive relationship between exchange rate misalignment and income elasticity of exports, suggesting that an overvalued exchange rate may lead to a primarization of the economy.

While there is a pattern of studies pointing to the causal relationship between exchange rate competitiveness and economic growth, some authors have found evidence on the contrary. Those studies highlight the mechanism between an appreciation of the exchange rate and the cost of imported intermediaries and capital goods used as export inputs. Zhang et al. (2018) decomposed China's intermediary and final imports, concluding that exchange rate depreciation played a smaller role in growth than previously suggested, albeit still a positive one. Sotomayor and Barajas-Escamilla (2020) found that the exchange rate is not a significant determinant of Mexico's exports. Ahmed et al. (2015) considered a panel of 46 countries for the period 1996-2012, concluding that the effectiveness of the exchange rate in promoting growth diminishes as countries get further integrated into Global Value Chains (GVCs).

In the case of Brazil, perhaps due to its low integration into GVCs, the competitive exchange rate has been repeatedly found to be a determinant of higher value-added exports (see Marconi & Rocha, 2012; Marconi et al., 2022), of economic growth (see Barbosa-Filho, 2004; Gala, 2007; Oreiro et al., 2011; Verissimo & Xavier, 2014), and of employment (see Frenkel, 2004). Porto and Marconi (2024) point out that Brazil's overvalued exchange rate has not only impacted its exports but has also led to demand leakages, resulting in local firms losing share in the international and domestic markets.

A policy of stable and slowly appreciating exchange rates during the catching-up phase, as implemented by South Korea (Li & Maskin, 2021), China (Xu & Yan, 2009), and, more recently, Vietnam (Pham & Nguyen, 2013), rewards long-term domestic and foreign investors. Policymakers in Brazil are lenient regarding exchange rate over appreciation, prioritising short-term political support over long-term economic development (Steinberg, 2015). Filho and Chamon (2008) demonstrated that currency appreciation has a short-term impact on income, which explains the popularity of overvalued rates. Exchange rate populism is attractive to politicians seeking re-election but hurts Brazil's growth prospects (Bresser-Pereira, 2020).

In addition to the chronically overvalued exchange rate, Brazil have maintained an appreciated interest rate to attract foreign capital in an

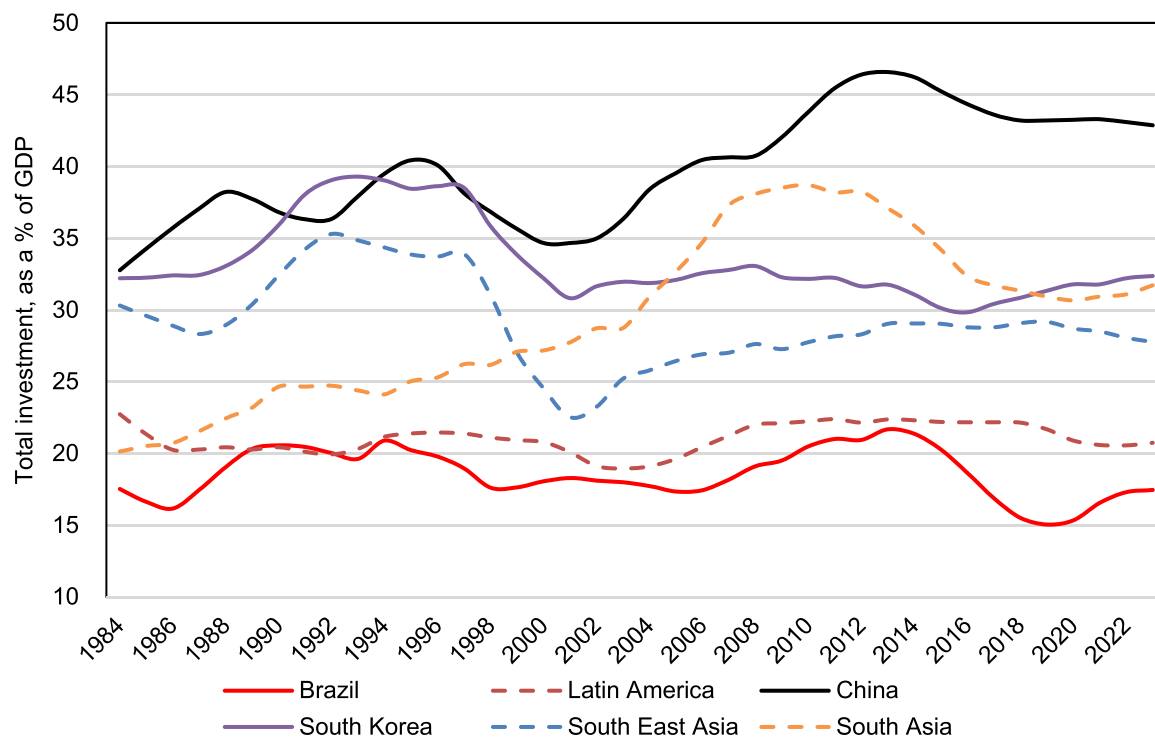


Fig. 4. Total investment (% of GDP), four-year moving average.

Notes. Gross Capital Formation [SNA 1993]. Latin America: Argentina, Chile, Colombia, Peru, Mexico. Southeast Asia: Indonesia, Thailand, Vietnam, Malaysia, and the Philippines. South Asia: India and Bangladesh. IMF (2024).

attempt to pursue growth with foreign savings (Bresser-Pereira, 2002; Bresser-Pereira & Nakano, 2003; Bresser-Pereira & Gala, 2009). Brazil's real interest rates remained among the world's highest even after inflation stabilised in 1994, further accentuating the exchange rate overvaluation. There is evidence that Brazil's high interest rate precedes and is positively correlated with country risk (Marques & Fochezatto, 2007) – proving Bresser-Pereira and Nakano (2002) hypothesis that Brazil's risk premium is self-fulfilling, with its high interest rate acting as a cause, not a consequence, of the perception of risk.

The set of macroeconomic policies, along with the retreat of Brazil's entrepreneurial state, hampered the country's chances of catching up. These policies favour short-term financial gains over long-term growth, increasing the preference for financial assets, including high-yield government bonds, over fixed capital investments. Since 1995, non-financial corporations have allocated an average of R\$8.63 in financial assets for every Brazilian Real invested in productive capacity, eight times more than during the catching-up period (Bresser-Pereira et al., 2020b). This is evident in Brazil's commodity derivative market, which has long surpassed total commodity exports, and in the elevated flow of interest payments on public debt, which consumes over a quarter of tax revenues yearly (Bruno & Gentil, 2022).

From a historical perspective, the persistently high real interest rates and overvalued exchange rate reflect the hegemony held by a pro-stability convention in Brazil, which prioritises price stability and free markets over economic growth and state intervention (Erber, 2011; 2012). This policy convention has found theoretical backing in the new institutional economics view, briefly discussed in the previous section. The presumed inefficiency of Brazil's government served as an argument to rule out developmentalist policies, such as national champion strategies, government-led industrial policy coordination, or targeted tariff protection, from policymakers' toolboxes. In sum, fiscal (including public investment) and exchange rate policies became subordinate to the inflation target, leaving the government with no role in development (Modenesi & Modenesi, 2015).

5. Discussion

The overarching prominence given to the inefficiency of government as the cause of underdevelopment has offered rhetorical support for policymakers opposing a larger entrepreneurial role of the state. In Brazil, the embrace of the second Consensus – namely, to reduce the role of government, emphasising the privatisation of government enterprises, trade and financial liberalisation, and market deregulation – was conveniently accompanied by a discourse on the evident pitfalls of its public sector. Hence, government interventions, once successfully adopted by Brazil and fast-growing Asian countries, were excluded from the political discourse, limiting the horizon of possibilities for policymakers in Brazil.

Since the 1980s, the primary goals of the Brazilian government have been limited to 'get institutions right' and maintaining stable prices, rather than overcoming underdevelopment. Understanding the winners and losers of this strategy provides insight into the incentives that have shaped policymaking. Erber (2011, 2012) identifies, among the winners, the exporters of commodities, intermediary goods, wholesalers, and retailers, all sectors with strong cash flows, capable of realising short-term gains. Among its losers are debtors, primarily the public sector, firms seeking investment financing, and households purchasing family assets.

According to Bresser-Pereira et al. (2020b), the winners formed a rentier-financial class coalition that is committed to maintaining this set of policies, exchanging long-term economic development for short-term gains from increased financialization. Contrary to the institutional argument, the Brazilian government has worked exceptionally well for this coalition, rewarding rent-seeking and guaranteeing a steady flow of public funds to its creditors – interest payments on public debt averaged 8 % of GDP since the 1990s (IMF, 2025), significantly more than in other

developing countries with similar or higher debt-to-GDP ratios.

The (re)emergence of an entrepreneurial state in Brazil, capable of playing a pivotal role in development, hinges on inverting the logic that currently guides political discourse in Brazil. More precisely, it is essential to recognise that poor institutions are, for the most part, a consequence, not a cause, of underdevelopment. Abandoning this tacit assumption that Brazil's institutions are incapable of efficiently allocating resources is part of the path for policymakers to change course and focus on policy levers that can promote long-term growth, and, in the process, allow Brazil to afford the much-needed better institutions.

CRedit authorship contribution statement

Matheus Terentin: Writing – review & editing, Writing – original draft, Investigation, Formal analysis.

Declaration of competing interest

The authors declare that they have no known competing financial interests or personal relationships that could have appeared to influence the work reported in this paper.

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