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Paper Proposal:

“The resilience of Brazilian economy against the international monetary crisis: the mitigation of financial fragility and the role of economic policy autonomy through the post-Keynesian approach”

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Abstract: the paper analyzes the impacts of the U.S. sub prime market's crisis on the Brazilian economy. Subdivided into three sections, section 1 will show the fragility on Minsky's approach in the international financial crisis, focusing on the role of expectations and uncertainties regarding the process of financial fragility in the capitalism. Section 2, will discuss the origins and consequences of the financial crisis on the high risk credit markets in the U.S. from mid-2007 – from a "classic credit crisis" to a "crisis of confidence". Section 3, the role of economic policy autonomy through the post-Keynesian approach and the impacts will be analyzed for the Brazilian economy, especially as regards the external sector of the economy, focusing on the impacts under the terms of the financing the balance of payments and reducing of financial fragility, compared to the previous period. Although the conditions of the Brazilian economy are better than in previous crisis, the depth of current crisis requires a fundamental change in macroeconomic policies implemented.

Key words: financial fragility, financial crisis, economic policies, post-Keynesian economy, Minsky.

JEL Classification: F30, F39, F49.

Introduction

The paper analyzes the impact of the international crisis resulting from the collapse of the subprime market in the U.S. market. This analyzes is into three sections. Section 1 will present the approach of Minsky's fragility in the context of international financial crisis, emphasizing the role of expectations and uncertainties of economic units and their influence on the process of financial weakness in capitalism.

Section 2, will discusses the origins and consequences of international financial crisis that originated in the credit markets of high risk in the U.S. from mid-2007. Given the interconnections of markets, has rapidly gained share, from a "classic credit crunch" to a "confidence crisis" The growing interconnection between international finance and the productive sectors has caused the crisis from spreading intensely affecting the performance of major economies.

Section 3, will analyzes the impact of the international crisis for the Brazilian economy, especially as regards the external sector of the economy and the level of activities. The hypothesis is that, although the conditions of the Brazilian economy are much better position than in previous adverse situation, the stiffness and depth of current crisis requires a fundamental change in macroeconomic policy.

Brazil has a good position in a context of World economy transformation, despite the necessity of a strategic repositioning. This implies on improvement in economic policies adopted, as well as, the articulation of a new development model that takes into account the risks and opportunities of financial globalization.

1. A post-Keynesian analysis of financial crisis

The post-Keynesian approach of Minsky¹ address the issue of financial fragility of capitalism through the systematization of a theoretical framework that encompasses the fundamental recognition of the importance of the expectations formation in the credit system and investment decisions.

For Minsky, agent's expectations are associated with uncertainties regarding present and future profitability of investments, as well as, the risk of projects, recognizing the impact on firms balance sheets on investment decisions.

¹ American economist of the post-Keynesian tradition that dealt, among other things, the possibility of financial instability of capitalism.

For Minsky (1986), investment decisions are a bet on the future, in a context which the evolution of economic variables are unpredictable and depend on the financing terms available.

The Minsky's analysis on the current financial crisis regarding to the increasing demand for general currency to meet the demands and fulfill commitments to the panic seen in financial markets resulting from the shortage of money supply. Faced with increased liquidity preference of agents, the market is declining.

The problem is not concern with liquidity lacks, but the "puddling" from the distrust in the financial market among banks and between investors. (Oreiro & Basilio, 2008, p. 61).

The decrease in the activity is regarding to, among other factors, credit crunches, has caused a fall in asset prices, generating a process of disinflation, with deep consequences for the real sectors of the international economy.

In the open-economy context, the financial fragility could be understood as a inherent tendency in the behavior of economic agents to broaden the participation of external financing for their purchases of capital assets (investment). Thus, there is more susceptible to the behavior of the economy, especially, the unstable and volatile financial market. The financial fragility of the resulting capital structure, as the relationship between debt service and net income required to service this debt.

The financial fragility concept denotes an interdependence among capital structure of companies and, especially, with the investment strategy and management of this structure. This interdependence could generate future obligations that due to the uncertainties and volatility in financial markets, could overcome the ability to generate cash. Thus, the financial fragility degree is not only considered by the composition of the economic unit's portfolio, but mainly by the ability to generate cash in this portfolio.

Applying the financial fragility concept, Minsky (1986) presents the economic units classification according to their financial position². The hedge financial structures whose economic units adopt conservative positions, generating the resources needed both to recover the funds and for interest rates payments. Now denote the speculative financial structures that assume postures with lower safety margins, not being able to recover its funds, one of the main

² For a more detailed analysis of the issue see LACERDA & OLIVEIRA (2009).

features of the constant need for refinancing needed for the payment of principal. Minsky also classifies a third called Ponzi financial structures, which economic units are considered an extreme case of speculative economic unit. There are ongoing needs refinancing needed for payments of principal and interest due. (Minsky, 1982, p. 67).

The process of financial debt structures mentioned above is applied in a capitalist economy to the analysis of investment decision. However, by relying on financial markets to the process of financing and refinancing of debt, financial structure acquires an unstable character, due to market volatility, which also causes the transition of economic units of the type hedge, like speculative or Ponzi .

In this sense, Minsky (1986) debt has a cyclical and inherently unstable, given the financing structure that is created during periods of prosperity, that is, a system predominantly hedge. Therefore, it can be seen that the processes of fragility and financial crises are generated endogenously, and has its heart in terms of funding / investment in the economy.

Minsky argues that the analytical core of the hypothesis of financial fragility is concentrated under capitalist conditions, in which the rate of investment depends on the conditions of funding, both internal and external sources, but mainly the latter. It is well laid, and endogenous cyclical hypothesis of financial fragility in Minsky.

In other words, in periods of prosperity in the economic cycle, demand for additional funding is increasing and the final decision lies with the agents financiers (bankers and businessmen of the financial sector). This decision will be modeled on the expectations of return on investment, which in periods of prosperity are commonly reviewed positively. Therefore, this cyclical pattern and almost natural capitalist economies is characterized by recurrent periods of financial fragility will only increase the unstable character of the economy.

In this sense, and according to the degree of financial fragility of the economic agents, Minsky concluded that the greater the weight of the hedge structure in the economy, the greater is its stability. While a growing share of speculative position and posture Ponzi indicate an increased vulnerability of the economy to financial fragility.

Briefly, as noted by Paula & Alves Júnior (1999), the concept of Minsky's financial fragility develops a measure to assess the capacity of an economy facing financial shocks, without distortion of the payment flows between agents.

From the analysis of Minsky, the next section will assess the impact of the crisis especially for the Brazilian economy, taking into account the degree of external fragility of the country and its consequences.

2. Origins and consequences of the crisis in the global economy

The current international financial crisis originated because of the credit markets with high-risk (subprime) in the U.S. from mid-2007. Given the interconnections of markets, has rapidly gained share, from a "classic credit crunch classic" to a "confidence crisis." The growing interconnection between international finance and the productive sectors has caused the crisis from spreading intensely affecting the performance of major economies.)

The uncertainty arising from the situation of large U.S. banks, especially as regards the quality of its assets, eventually led to the paralysis of the interbank markets. This is a classic situation in which, given the uncertainty, most agents prefer to retain their assets in cash, or alternatively in assets considered of high liquidity and security in the event, usually Treasury bonds U.S.. The mutual distrust between banks and for those with businesses and individuals leads to the "liquidity preference" in the definition of John Maynard Keynes. (Keynes, 1936, p. 149).

In crisis, banks have tighten up their criteria for lending and increased their spreads, restricting the supply of loans, causing the "puddling credit" in the markets. So this was one of the main elements of contagion between the financial crisis and the crisis arising in the real economy. To the extent that there was paralysis of the credit transactions that affected the meaning of an additional drop in the level of activity.)

In order to reverse the effects of the crisis, governments and central banks of developed countries have articulated coordinated actions. This is an unprecedented, given the volume and intensity of interventions. There were massive injections of liquidity in the markets, mainly through loans, financing, including, in some cases, with the nationalization of banks (e.g. England) and portfolios of credit / financial operations of financial institutions that held so-called "toxic debts". There was also a reduction or even extinction of securities on

financial institutions by the monetary authorities, and these increasingly taken their role as lenders of last resort.

The crisis of 2009, unlike its predecessor in terms of intensity, of 1929, takes place under the aegis of financial globalization, which is the new phenomenon, manifested in the last quarter of the twentieth century. The sophistication of mutual funds, pension and hedge funds, capital markets, foreign exchange, private equity, derivatives, among others, created a new world. In addition, technological innovations have dramatically reduced transaction costs, speeding the flow of information. Markets are increasingly interlinked, working online, 24 hours a day, began to establish a framework of liquidity and unprecedented volatility in global economic history.

This new framework, under the clear supremacy of the U.S. dollar, has made the financing of the globalization of trade and production, while enhanced the volatility and instability in global financial markets. Given the weakness imposed by the new circumstances at the multilateral post-Bretton Woods institutions, especially the International Monetary Fund (IMF) and World Bank, created a vacuum reference in the international financial system.

The alternative to non-emitting convertible currencies was to adopt a clear strategy of accumulating foreign exchange reserves. It is noteworthy that a significant portion of these reserves finance the external deficit of the U.S., through investments in government bonds.

This scenario has become quite favorable to the U.S.. As the main emitters exclusive international reference currency could afford to keep the economy growing, filling up the manufactures from China. The external deficit can be financed due to lower low real interest rates, the growing demand for North American securities, absorbing global liquidity. The U.S. economy has the privilege of being the exclusive broadcaster of the dollar, still the reference currency of international accounts for about 75% of all transactions worldwide and around 65% of foreign exchange reserves of central banks of other countries, estimated at USD 7 trillion at the end of 2008.

Despite the crisis, the dollar and bonds issued by the U.S. Treasury following playing the role of refuge for the applications and liquidity preference. This means an important asset to create the conditions for a faster recovery of the U.S. economy.

The disinflation and liquidity brought about the U.S. funding to real interest low rates. Fine adjustments in the calibration of interest rates led by Greenspan and Bernanke later, after the bursting of the bubble of "irrational exuberance" in the New York Stock Exchange from 2000-2001, Inject liquidity in the global economy.

The fact is that the framework of international liquidity also encouraged the carry trade operations, the taking of resources to real interest rates low, often negative, to speculate in commodity funds, real estate markets and capital, etc. .. around the world. The so-called subprime market spaces, increasing distrust, even in America. Gained space loans to borrowers with low capacity payments.³

What has changed is that these loans have become securitized through the issuance of securities transferred to third parties. So that the default risks and its effects end up infecting other assets and markets. Much of what is observed in the behavior of stock markets and currencies from Lehman Brothers in September 2008 showed a picture of panic, in a desperate attempt to "repricing", for a strong downward correction in asset prices.

The increasing interconnections between the markets of the countries, and between these and the real economy, the game became increasingly complex and volatile. The increased interdependence among countries increases the challenge for central banks and multilateral agencies for the management of (un)economic order. Another important factor will be whether extraordinary ability to innovate in the financial market and U.S. will be able to mitigate and even shorten the instability, depending on further factors already mentioned.

In order to mitigate or reverse the crisis and its effects can be observed that the main monetary authorities in developed countries have articulated coordinated action with massive injections of liquidity in the markets, mainly through loans, financing, including the nationalization (especially in Europe) portfolios of credit / financial operations of financial institutions that held so-called "toxic loans". There was also a reduction and even extinction of securities on financial institutions by the monetary authorities, and these have assumed the responsibility of lender of last resort.

³ It was the phase in which the so-called market loans to customers NINJA (**No Income, No Jobs, No Assets**).

3. As Brazil has been affected by the crisis

The Brazilian economy, as it should be, has been negatively affected by the crisis. However, as we shall see, the macroeconomic conditions today are much better than in other crises. The big structural change came from the substantial reduction of oil dependence. This was due to a successful program to increase oil production, as well as the change in the energy, with the incorporation of ethanol and other renewable energies. Our dependence on imported oil, which was 90% of domestic consumption in the two shocks of the 1970s, was reduced to only 5% in current times.

Another change came with the lowering of the external vulnerability of the economy, with the improvement in indicators such as level of foreign reserves, reducing the proportion of external debt relative to GDP or exports. Although Brazil is still heavily dependent on commodity exports, which is a liability in the crisis, on the other hand, there were a significant diversification of destination markets. Total exports, only 15% goes to the U.S., while 25% go to Europe, Latin America 20% and 15% for Asia, highlighting key. Quite the contrary from Mexico who directs 90% of foreign sales to the U.S. market.

Since 2002, the growth of world trade growth and commodity⁴ prices were instrumental in the Brazilian export performance. In 2008, the Brazilian export volume recorded a revenue of USD 197.9 billion, almost four times the volume recorded in 1997, of USD 52.9 billion. While imports have more than doubled in the period, it was still possible to achieve a significant trade surplus.

The positive performance of the balance of payments was one of the determinants of relative improvement occurred in the indicators of external fragility of the country. The increase in capital flows, with greater availability of external funding has improved the level of international reserves to a record USD 200 billion at the end of 2008, and create the conditions for the reduction of external debt the country.

On the side of the capital accounts and financial FDI's role, contributing significantly to the total financing of the external accounts. In 2008 it was

⁴ According to the index CRB (Commodity Research Bureau), which is an indicator that represents a basket of major commodities traded in the international market, the average price of commodities grew by 150% from 2002 to September 2008.

announced a record inflow of foreign direct investment (FDI), which reached USD 45 billion of flows in the year.

The country has a country's position as an international lender. The total foreign assets⁵, exceeded from 2007 to total gross external debt⁶, which approached USD 194 billion, making negative net foreign debt⁷.

The external fragility can be assessed by the degree of dependence of national states in an external. From the economic point of view can be given the dimensions financial, commercial, technological and production-real. (Gonçalves, 1998, p. 9).

The increased fragility, according to Minsky, is manifested in less autonomy in the country, both in conducting its economic policy, as in the contagion of external crises. In the context of finance, the weakness is associated with dependence on external resources to cover the financing needs of the balance of payments.

In the commercial, that fragility increases when increases the coefficient of imports, both by the effect of trade liberalization, ie, reduced barriers to foreign goods, such as by reducing import tariffs and removal of restrictions. This weakening process is even more intense, if not accompanied by an expansion of exports, generating both direct impacts on the trade balance, as the generation of local added value, affecting the survivability and growth of businesses and the resulting impact on the labor market.

The limitations to the autonomy of domestic macroeconomic policies may become unstable level of activity and other economic indicators. The result is that the performance of the national economy tends to become increasingly dependent on what happens in the international arena. Localized crises in other developing countries tend to influence others, especially those that depend on external financing.

In times of turmoil, the markets are more selective, reducing their applications in countries with higher risk and this creates a fertile field for speculation and the weak, often at the expense economic growth in a sustainable

⁵ The total assets amounts to international reserves accumulated credits Brazilians abroad and the assets of commercial banks.

⁶ Gross external debt includes the debt recorded and unrecorded. (Obtained from the Accounting Plan of National Financial Institutions), and the credits Brazilians abroad (Brazilian Central Bank).

⁷ The net external debt is obtained from the gross debt by subtracting the figures for international reserves in the concept of international liquidity, the assets of commercial banks abroad. (obtained through the Accounting Plan of National Financial Institutions - COSIF). (Brazilian Central Bank).

basis. Hence the importance of the progress made on the improvement of external performance of the country, without which the impact of the current crisis would be greater.

This, however, does not allow the complete immunization of the Brazilian economy. The worsening of the international crisis has generated significant effects on the level of activity. The fall of 3.6% in Brazilian's GDP (Gross Domestic Product) in the last quarter of 2008 and 0.8% in first quarter of 2009 has sharpened the debate on ways to get out of the crisis (Figure 1).⁸

**Figure 1. The international crisis impacts
Brazilian and other selected countries/region – GDP (Var. %)**



Source: National Statistics Offices / International Monetary Fund (IMF)

Despite the negative results mentioned above, the Brazilian economy has recovered from this strong negative impact, growing 1.9% in second quarter of 2009, and this is a sign of rebound of sustainable economic growth.

The country has a good macroeconomic condition, considering the external accounts and other indicators. However, the performance of the economy will depend crucially on decisions and the ability to implement measures to combat the effects of adverse external scenario.

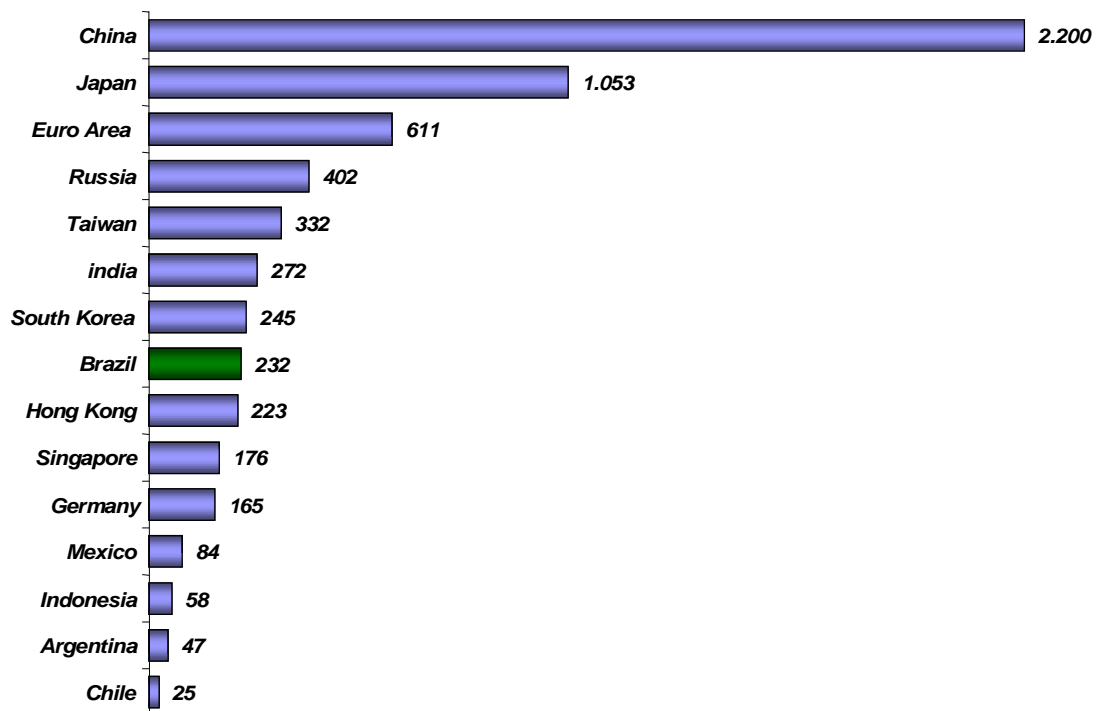
⁸ More intense still was the slump in industrial production in the first two quarters of the crisis (the fourth in 2008 and the first of 2009) fell by 10% over the same period of twelve months.

The international financial crisis in the context of the Minsky's fragility approach focuses on the expectations and uncertainties of economic units and their influence on the process of financial instability in capitalism. According to this approach, the financial instability of modern capitalist economies is the result of the self structure of market mechanisms, ie, the core of a financial crisis is in itself and routine working of the economy being independent of the occurrence of exogenous shocks, hence his endogenous.

The increased flows of foreign capital, long-term (investments), the high international reserves, which topped USD 200 billion at the end of 2008, besides the reduction of external indebtedness of the country, were the main positive factors on the balance of payments observed in the midst of the current crisis, which culminated in the relative improvement on the indicators of external fragility of the country.

Moreover, despite the negative effects of international crisis, there was an increase in international reserves, reaching USD 232 billion in October 2009 and the Brazilian economy is the eighth largest country in terms of international reserves accumulation (Figure 2).

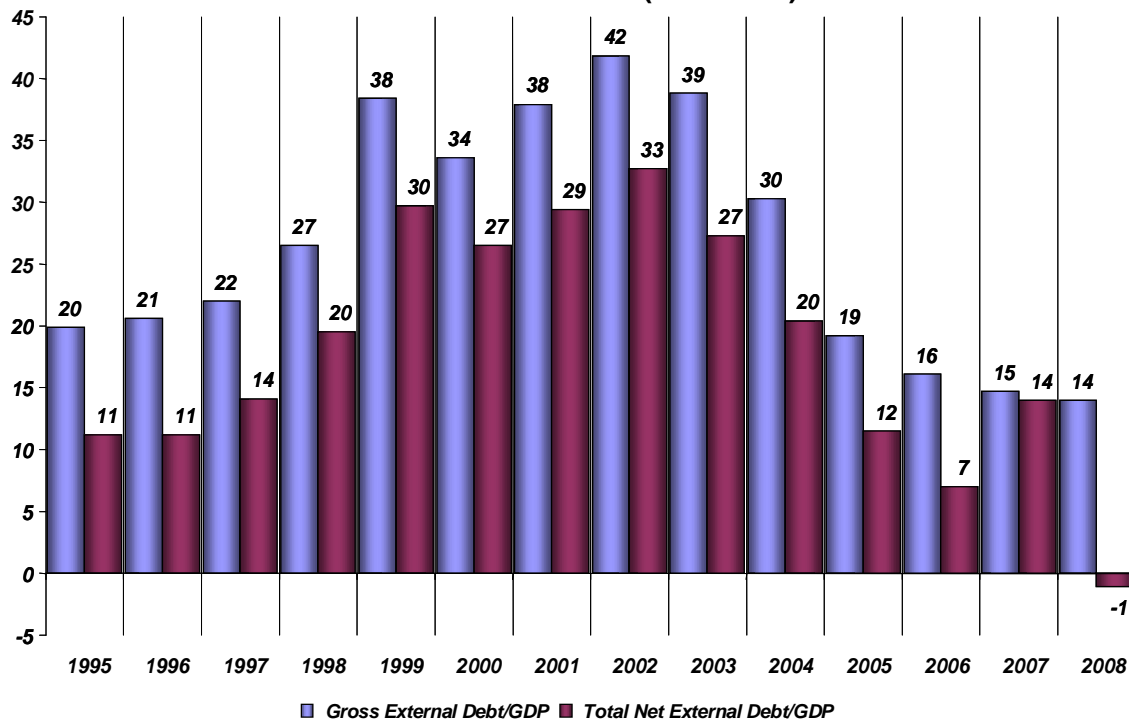
**Figure 2. Selected countries/regions:
Highest international net reserves (USD Billion)**



Source: International Monetary Fund (IMF)

The significant international capital flows directed to Brazil, especially, foreign direct investment (FDI), combined with the intensification of the policy of the surplus in trade balance, increased levels of foreign reserves, as well as, imbalances in the balance of payments, causing a marked a notorious improvement – reduction of Gross External Debt / GDP of 42% and Net External Debt / GDP of 33% from 2002 to 14% and -1% in 2008 – denoting an improvement of Brazilian external fragility, compared to previous periods, as seen below in Figure 3.

**Figure 3. Brazilian External Vulnerability
Gross and Net Debt (% of GDP)**



Source: Brazilian Central Bank (BCB)

Thus, considering the type used by Minsky, Ponzi's position, predominantly in the managed exchange rate regime (1994-1998), changing to a hedge position since 1999, with this changes in the profile of external debt and the external fragility degree of the Brazilian's economy. Although the country has been showing an improvement in the indicators of external fragility compared to previous periods, is not enough to immunize the Brazilian economy to external effects of systemic crisis.

Conclusion

The financial globalization and the slowdown of major economies bring undeniable challenges and difficulties for developing countries. In external financing faced with the global credit crisis, represents a problem for all countries. Brazil has regained the current account deficit of balance of payments, which reached USD 28 billion over 2008, after six years of surpluses. This means that the country depend on external resources, right in the middle of the international financial crisis.

The international crisis to should constraint the capital flows abroad all countries, and Brazil, despite a relatively good situation of their external accounts, will also be affected. This also applies to foreign direct investment, which should experience a significant contraction. The contraction of the economy of many countries and falling prices of commodities exported by Brazil are going to negatively impact export revenue.

The lower growth of the economy should slow the pace of imports, which also have an impact, if positive, on the fall in international prices. The change more devalued will also reduce remittances of profits and dividends. This reduction occurs not only for accounting effect - the profits made in real turns into a smaller volume of U.S. dollars, with the devaluation - but also because many companies anticipated their remittances last year, at the height of the international crisis.

But it is worth noting the relative ease in the short term, on the other hand, it eliminates the need to define and implement a more solid support intertemporal strategy for external accounts. This is a qualitative improvement in Brazilian exports, for which one must seek to generate greater value and a lower dependence on demand for commodity prices. The internationalization of Brazilian companies may also be important to a qualitative improvement of international integration.

Exchange rate policy should be used to reduce the volatility of the exchange rate. Just as in times of acute crisis were devaluation, the gradual return of foreign capital inflows should instead provoke a new process of upgrading the real. This process has a high economic and social development, industrial restructuring, the potential imbalance in the external accounts and the loss of potential growth of the economy.

Decisions involving the countries economic policies always involve choices. We must establish priorities and to centralize the focus of the action, without losing the strategic vision of long-term. Especially in crisis, this will be a determining factor of the differential performance of developing countries.

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