EXCHANGE RATE, INCOME DISTRIBUTION AND TECHNICAL CHANCE IN A BALANCE-OF-PAYMENTS CONSTRAINED GROWTH MODEL

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Abstract

This paper sets out a formal model to account for what would be the net effect of an exchange rate undervaluation on both income elasticities of demand for export and imports and, consequently, on the long-term balance-of-payments constrained growth rate. Such a model shows how the exchange rate impacts on the home country specialization pattern via changes in the variables of the economic structure such as the income distribution and technological change. This model is built upon two basic hypotheses. Firstly, it assumes technological improvements impact positively on income elasticity of demand for exports and negatively on income elasticity of demand for imports. A devaluated exchange rate improves exports competitiveness, on the one hand, which accelerates technological progress pace and prompts the economy to specialization pattern changes. It also, on the other hand, induces to import substitution of high-tech products by increasing the non-price competitiveness of the domestic goods. An undervalued currency modifies the profit share on income which might lead to more (less) investments in R&D and boost (harm) technological progress. Secondly, it assumes here that improvements in income distribution reduce income elasticities of demand for imports. It can be argued that an increase in wages share at expense of profits share on income would reduce capitalists' saving and consequently their capability of consuming superfluous and highly technological foreign products. This argument was first put forward by Furtado (1968). In other words, a currency undervaluation can lead to a change in the consumption pattern via income distribution modifications.