Monetary policy in Brazil under the inflation targeting regime from a Contested Terrain Approach

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1. Introduction

As is well known, monetarist and new-classical economists, such as Friedman (1968, 1970), Kydland and Prescott (1977) and Lucas Jr (1972), argue that monetary policy decisions made by independent central banks are 'neutral'. Thus, the monetary policies operated by central banks reflect society's preference as a whole, with no significant bias in favor of a particular group. In contrast, for the Contested Terrain Approach (CTA), developed by Epstein and Schor (1988), monetary policy mirrors the correlation of forces in society and the central bank's structure. In the current phase of capitalism, marked by the financialization of economies, rentiers are stronger than other groups in society, so that monetary policy tends to favor this class fraction.

In nowadays, in most economies which the central bank became independent, and the Inflation Targeting Regime (ITR) was adopted to keep inflation under control, monetary policy has been largely beneficial to rentiers. Thus, economic growth is no longer relevant for most central banks worldwide, especially for emerging economies. In Brazil, for instance, since the implementation of the ITR in June 1999, the no-neutrality of the Central Bank of Brazil (CBB) in terms of operating the monetary policy, that is, the nominal base interest rate (Special System for Custody and Settlement of Government Bonds – SELIC), has favored rentier interest more than other economic interest.

Although the central bank became conservative, and, as a result of, monetary policy favors rentiers, the Brazilian case certainly stands out. Since the mid-1990s, Brazil has had one of the highest basic interest rates. Not even price stability and consistent primary surpluses throughout the 2000s could get the country out of this uncomfortable place, although the real interest rate showed a downward trajectory during this decade and the beginning of the following decade. The context of economic prosperity partially hid the harm associated with this very high interest rate. However, when this phase passed, the obstacle represented by high interest rates was still there. It took a major recession, starting in 2015, for this rate to approach the average level of developing economies, including those in Latin America. At the same, the Brazilian

economy became increasingly financialized in this period. In light of this briefly described framework, we consider that the rentier segment of society captured the CBB. This is the main objective of the chapter.

To address this objective, besides this brief Introduction, the chapter is divided into three sections: section two presents the theoretical analysis of the CTA; section three describes and analyzes the performances of ITR and monetary policy from 1999 to 2020; and section four concludes.

2. A theoretical analysis of the CTA

The CTA was developed to analyze some advanced developing countries' macroeconomic policies, particularly monetary policy, in the post-World War II period (Epstein and Schor, 1988). For CTA, the central bank is a terrain of class struggle, and therefore the monetary policies will mirror the net outcome of that struggle. Epstein (2001) sought to adapt this model to the reality of developed countries undergoing the financialization of their economies. Apparently, according to him, the influence of rentiers over the central bank in these countries has expanded significantly in recent years, so that the struggle between capitalist class's fractions over monetary policy has lost strength in this period, giving way to a control of the central monetary institution by this segment. Epstein (2019) explains this idea when the term 'contested terrain' was abandoned, and, as a result of, 'contested control' was used to refer to the new relationship between the dominant class fractions and the monetary authority.

The real interest rate is considered in CTA to be a variable under the control of the central bank and at the same time a crucial distributive parameter in the economy (assumptions in line with the Post-Keynesian school, but also with Marxian approach). In this way, the different classes and fractions, divided, simplistically, into financial capitalists, industrial capitalists, and workers will seek to influence the central bank's behavior to bring the interest rate closer to the level that maximizes their income share. Financial and industrial capitalists are assumed to want to increase their profits, while workers are concerned with real wages. Monetary policy will be a weighted average of these objectives, with the weight of each determined by the relative power of these groups in society and the state.

Besides the conflict between these classes and fractions, monetary policy is also constrained and influenced by some structural/institutional features of the economy and the central bank itself. Based on econometric studies, documentary analysis, interviews

with policymakers, and Marxists theories of State – such as Esping-Andersen et al. (1976) – Epstein and Schor (1988) listed four characteristics as being the main ones, besides the contradictions and the dynamics of capital accumulation:

(i) The structure of the labor market;
(ii) The relationship between the industrial sector and the financial sector;
(iii) The degree of independence of the central bank;
(iv) The insertion of the domestic economy in the world economy.

The structure of the labor market (or capital-labor relations) is addressed, in the most stylized versions of this model (Epstein, 1992), by referring to only one specific outcome arising from this structure, namely, the relationship (positive or negative) between utilized productive capacity and the share of profits in income. Moreover, Boddy and Crotty (1975) observed that the profit-wage ratio suffers a compression (profit squeeze) in the second phase of cyclical expansion, due to a significant increase in real wages in this phase, because of the fall of the industrial reserve army and greater bargaining power of the working class. At the same time, there is a drop in productivity growth *vis-à-vis* the first cyclical expansion phase, explained either by technical issues or by the increase in the number of strikes and the lower effort of workers on the factory floor in this period (stimulated by the moment of economic prosperity). This profit squeeze would add to the political-ideological aspects that Kalecki (1943)[1] raised to explain the capitalist class's resistance to situations of full employment of productive factors. A labor market with these characteristics, that is, one that presents the mentioned phenomenon of profit squeeze, has received in CTA the label of neo-Marxist. In this case, industrial capitalists will be opposed to monetary policies that cause full employment.

[1] For Kalecki (1943), the resistance of capitalists to full employment policies observed throughout the 1930s cannot be explained by a fall in the rate of profit since the increase in real wages provided by this situation would tend to be reflected more possibly in prices than in profits. Thus, the cause of this opposition was the result of political and social transformations caused by the maintenance of a situation of full employment, as well as the capitalists' natural aversion to any government intervention, particularly those that interfere with the capitalists' power to determine the level of employment in society. The so-called 'economic experts' and rentiers, who are against the boom because of its effects on the price level and the value of financial assets, support such opposition from the 'captains of industry', whose concern about 'factory discipline and political stability' is more significant than about profits.

As extracted from Kaleckian economic theory, if the increase in capacity utilization were accompanied by a decrease in competition and an increase in the market power of firms, firms could increase their mark-up, so that the share of profits in income would also increase or, in the worst case, would remain constant. In this case, industrialists would 'unite' with workers in defense of full employment monetary policies. It should be noted that this direct or inverse relationship between utilized capacity and the share of profits in income is influenced by the organization of the working class in the respective country and by its political capacity to participate in the productivity gains that occur in moments of cyclical expansion. The more robust and less internally divided the workers' movement is, the more the labor market approximates to the neo-Marxist case.

In Epstein and Schor (1988), besides this aspect, labor legislation is also mentioned as a factor that can influence the behavior of the capitalist class concerning monetary policy. Supposing that a given country has employment protection laws that make it expensive to lay off workers, capitalists will tend to adopt a more neutral stance on this issue, because, on the one hand, a contractionary monetary policy will possibly not bring the reduction of unit labor cost in the expected proportion, and, on the other hand, it is not advantageous for capitalists to hire workers that will be expensive to lay off later.

It is essential to point out that by treating the distribution of income between capitalists and workers separately from the monetary factors, one excludes the possibility that a reduction in the interest rate (and a drop in the share of rentiers in surplus) would serve as a counter to the crushing of total profits in income. That is, if the model addressed the conflict between workers and capitalists and between industrial capitalists and finance capitalists simultaneously, even if the labor market were neo-Marxist, industrial capitalists' profits could to some extent remain constant or even increase as a result of an expansionary monetary policy leading to a situation of full employment.

According to Epstein (1992), Marx considered that there were grounds for conflicting relations between finance capital and industrial capital, because of the distribution of surplus-value into industrial profits and interest, but also for cooperation between the two *vis-à-vis* the working class, because they share the exact total after subtracting wages. However, it is generally assumed that industrial capitalists and rentiers are on opposite sides in the struggle to determine the interest rate. This Marx'

assumption was also endorsed by Keynes. In his *A Treatise on Money: The Pure Theory of Money*, Keynes ([1930] 1976), after defining the industrial circulation and the finance circulation of the capital, argued that monetary policy is not able to reduce quickly the interest rate because the speculators (or rentiers) attempt to stop this drop. As a consequence, 'a state of unemployment may be expected to ensure' (Keynes, [1930] 1976, p. 206). Later, in his *The General Theory of Employment, Interest and Money*, Keynes ([1936] 2007, p. 376) stated that it was necessary to promote the 'euthanasia of the rentiers'; that is, an abrupt reduction of the interest rate to stimulate consumption and, mainly, investment, thus resulting in an economic situation of full employment. In this way, it can be said that workers and capitalists formed the political alliance envisioned by Keynes against rentiers, which paralyzed the creative impulses of society. The market rate of interest does not drop quickly enough, because speculators of the stock exchange will attempt to stop it above equilibrium level.

Based on Zysman's (1983) classical book, *Governments, Markets, and Growth: Financial systems and politics of industrial change*, Epstein (1992) argues that the relationship between industrial sector and financial system around the world cannot be framed within the idea that there is a conflict between them. In the so-called credit-based systems, whose emblematic cases are Germany and Japan, the banks, the main financiers of investment in this type of system, have a high share in the assets of the industrial sector, such that they have an interest in a monetary policy that also expands the profits of this sector. In Japan, these sectors are sometimes part of the same industrial group, so a change in the interest rate has the same impact on these companies as a change in the relative prices of the goods produced by different arms of this group. In these cases, the impact on the distribution of income between the industrial and financial sectors caused by a change in the monetary policy stance will be reduced, which encourages cooperative behavior between the two (read both will defend an interest rate that maximizes their profits jointly). Epstein (1992) called financial systems with these characteristics enterprise finance, in contrast to cases of speculative finance, in which conflicting relations between the two sectors prevail. The generally mentioned examples of the latter are United States and United Kingdom, although the large-scale deregulation of financial systems that have been promoted in the last decades has brought a significant part of the economies closer to these cases.

In contrast to credit-based systems, the primary source of investments in these countries are the stock and bond markets (which is why they are called capital market-

based systems). In this context, since banks have a smaller share in the industrial sector, a change in the interest rate causes a redistribution of income across sectors. Consequently, the financial sector will advocate a behavior by the monetary authority that maximizes its profits despite the profits of the industrial sector.

One of the characteristics of developing economies is not having a developed private financial system that provides long-term capital for capital accumulation. In other words, in these economies, the industry still depends largely on self-financing, on the external financial system, and, in some cases, on public institutions and development banks. Thus, the linkages between banks and industry are weak in economies such as Japan and Germany, and the capital market is not as developed as in the United States and United Kingdom. Given this, we think that the distinction between speculative finance and enterprise finance should be slightly modified to address these economies. Instead of focusing on the source of funds (capital markets or banks) for the financing of industry, one should consider the orientation of banking activity, that is, the extent to which banks are geared towards lending to the real side of the economy or investing in the financial sphere.

Financial capitalists' resistance to an expansionary monetary policy is also linked, in our view, to the general conditions of the economy. If inflation is high, finance capitalists will strongly oppose any measure that expands the money supply in the economy. With inflation under control and at a low level, the central bank should encounter more resistance from the financial system to a fall in the real interest rate when the economy is stagnant than growing at high rates. In this case, they will maintain their profitability even with the fall in return provided by financial assets.

For CTA, the state's internal structure (in this case, the relationship between central bank and government) also matters in determining the policies to be adopted. According to Epstein (1992, p.11), '[w]hile classes and class fractions have desired policies, their policies will not be implemented unless they have political power *vis-à-vis* the state. Thus policy will be determined by a combination of political structure of the economy and the political structure of the state.'

Given that, CTA assumes that the more independent the central bank is from the government, the more restrictive monetary policy tends to be, as the support of the financial system will be more important to guarantee this independent position. In the cases seen above in which the industrial and financial sectors share the same interests concerning monetary policy, an independent central bank will adopt monetary policies

that also maximize the profits of the industrial sector. Nevertheless, in situations where these interests diverge, the central bank will serve the interests of its natural allies, the rentiers. Thus, it is assumed that workers' interests tend to be ignored by the monetary authority, and they become even more irrelevant in determining monetary policy when the central bank gains independence from the government since the only channel of influence they had over the behavior of this institution (via pressure on democratically elected representatives) is thereby closed.

Besides the econometric evidence, the reasoning above is supported by documentary analysis of the formulation and execution of monetary policy in the United States. Epstein and Schor (2011) examine the battle waged by these divergent interests in the period leading up to the Federal Reserve-Treasury Agreement in 1951, which reestablished the independence of the Federal Reserve Bank (FED) after a few years in which monetary policy was subordinated to the need to finance World War II at the lowest possible cost. The history of the agreement shows that not even the financial community was, from the start, unanimous about the independence of the FED. The almost complete support of this community was won by the substitution of the main instrument for the execution of monetary policy – which became the interest rate, instead of banks' mandatory reserves –, as well as by decisions taken (first to reduce and then to increase the interest rate) perfectly aligned with the interests of the large banks. Industry's support, in turn, came only belatedly and was motivated by the desire to prevent quantitative credit controls from being implemented and monetary policy from being placed under the command of the Executive Branch, as planned by groups within the government that supported President Harry Truman. In contrast, throughout the clashes, workers showed relative indifference to these issues, being indirectly represented by the most radical elements present in the public administration. The signing of the Accord, according to the Epstein and Schor (2011), represented an attempt to prevent these radical forces from interfering in the execution of monetary policy henceforth, isolating it permanently from the (in the words of one of the FED directors) 'negative' influence of workers.

Besides domestic conditions, the country's insertion into the world economy is considered by CTA because it affects the interests and constraints faced by central banks. Small and open economies do not constitute the field of analysis of this approach since the monetary authority does not execute policies autonomously. Central banks in larger economies, but with broad insertion in international capital flows, are also often

held hostage by the balance of payments imbalances. The more integrated an economy is, the greater the chance that a crisis of this nature will strike it, disrupting the scenario for the execution of monetary policy. In turn, having key currencies in the international scenario sharpens the central monetary institutions concern with domestic stability conditions, stimulating more restrictive behavior on its part. This concern is corroborated by the speculative and outward-looking financial systems found in these economies, for which stability is fundamental to guarantee a continuous flow of investments. Finally, in open economies, a substantive rise in the unit cost of labor is responded to by multinational firms with a shift of production to locations with the cheapest labor (Epstein, 1992; Epstein and Schor, 1988).

As Epstein (2001, p.1) states, '[...] the increasing importance of financial markets, financial motives, financial institutions, and financial elites in the operations of the economy and its governing institutions, both at the national and international levels', that is, financialization has led to a change in the political economy of central banks, especially in the United States. The interests of capitalists and financiers have become coincident about the optimal level of the interest rate. Whereas before financialization, the greater aversion to inflation of rentiers typically made them want higher interest rates than industrialists, this distance has narrowed significantly in recent decades for many reasons. On the one hand, industrialists have become much more like rentiers, as financial gains have become more critical in their income. However, this has paradoxically not led to a change in their position concerning the interest rate, since inflation is no longer as much of a concern as it used to be, due to changes in the labor market (weakening of unions and competition with cheap labor from developing economies) and the importation of comparatively low-priced goods from these economies. On the other hand, rentiers and industrialists prefer capital gains obtained by speculative bubbles inflated by meager interest rates. In short, both maximize their rate of profit with interest rates at a depressed level.

Epstein (2001) also argues that the success of the ITR among economists and policymakers, and its adoption by several countries over the past decades, cannot be explained from the standpoint of purely technical analysis. One of the main arguments raised by advocates of the ITR is that its adoption would reduce the cost in terms of output and employment associated with the disinflation process, the so-called 'sacrifice ratio'. However, according to Epstein's (2001) literature review, there does not seem to be evidence that this has happened. Furthermore, the great concern with inflation, which

motivated the adoption of the ITR, is not justified from the empirical point of view. The results of previous works and of econometric exercises carried out by Epstein (2001) show that moderate inflation (below 20.0%) does not generate high costs in terms of reduction of product, investment, the inflow of direct investment, and other real variables. Against this background, he suggests the ITR fever needs to be understood within the context of the financialization of economies and the increasing power of rent-seekers.

As is well known, financialization manifests itself differently in developing economies. Instead of capital gains and low interest rates, one sees gains from financial instruments (government bonds, for example) that pay high interest rates. Moreover, financialization has an 'extroverted' character, that is, it is associated with the inflow of capital and, therefore, with their financial openness. For capital to continue flowing to developing countries, they are forced to maintain high interest rates, resulting in an appreciated exchange rate and a negative impact on the productive structure and economic growth and generating more outstanding state indebtedness (Becker et al., 2010). In Brazil, although financialization has its roots in creating the so-called 'indexed currency' in the 1970s, this process gained strength from the 1990s, with the opening (trade and financial accounts balance of payments) of the economy and the macroeconomic paradigm change (Bruno et al., 2011). In this context of financialization and rentier domination of the CBB, Brazil adopted the ITR, whose performance will be analyzed in the next section.

3. The performances of ITR and monetary policy in the period 1999-2020

Since the introduction of the ITR Brazil has had very high nominal and real interest rates, when compared to other countries with similar levels of income: the average nominal and real SELIC, from 1999 to 2020, were 12.4% and 5.7% per year, respectively.[2]

This raises two questions: How CBB has managed the monetary policy monetary since then to keep such relatively high interest rates? What have been the main influences on the policymakers in operating the ITR? Looking at the performance of the monetary policy since the 1990s, specifically after the *Real Plan*, July 1994, there are, at least, two explanations: first, in general and mainly between 1994 and 1998,

[2] Author's calculations based on statistical information from Ipeadata (2021).

when the exchange rate was the anchor of the stabilization prices, CBB has decided to maintain high nominal interest rates in order to attract capital flows to finance the current account deficits (Ferrari Filho and Paula, 2003); and, second, after the introduction of the ITR, the monetary policy has been operated according to the most important issue highlighted by the New Macroeconomic Consensus (NMC) theoretical framework, in which, in Brazil, the interest rate seems to have only one economic objective, that is, to bring the inflation rate to its target or to its tolerance intervals without worrying about economic growth and employment.[3] Thus, as a result of high interest rates, the monetary policy managed by CBB favors rentier interests (domestic and foreign rentiers) mainly because high interest, in a context of financialization of the economy, insures the rentiers' earnings against possible losses determined by this policy.

Given that, it is possible to argue that monetary policy in Brazil, on the one hand, has been quite ineffective in fulfilling its objective main objective, that is, to keep inflation under control and stimulate economic growth, and, on the other hand, it has contributed to income and wealth concentration, once high interest rates are important source for the rentiers gains.

This section presents the macroeconomic model utilized by the CBB to adopt the ITR, analyzes the Brazilian experience with ITR and shows how high interest rates in Brazil ensure the rentiers' earning.

3.1. The NMC basic model and the Brazilian experience with ITR[4]

The NMC model emerged in the beginning of the 1990s, and, since then, has become highly influential in terms of both macroeconomic thinking and macroeconomic, mainly monetary, policy (Arestis and Sawyer, 2008).

The basic NNC model is characterized by three equations: the IS equation representing the demand side; the Phillips curve (PC) equation representing the supply side; and the monetary policy rule (MPR) equation (Carlin and Soskice, 2006).

The MPR is the underpinning of the ITR.[5] The rule fixes the central bank behavior under conditions of mostly demand shocks that deviate inflation from the target under rational expectations by key private players. In this approach, the

[3] From 199 to 2020 the average annual GDP rate was 2.0%, while the average unemployment rate was 8.9% per year. Author's calculations based on statistical information from Ipeadata (2021).
[4] This subsection is based on Araujo et al. (2018).
[5] Some theoretical arguments and empirical evidence on ITR can be found in Bernanke et al. (1999).

instrument of monetary policy is the short-run nominal interest rate. When actual inflation rates converge to the inflation target established by the central bank, the interest rate is assumed to be on its natural level.

As it was mentioned before, CBB introduced the ITR in 1999, along with a target for primary fiscal budget surpluses as share of GDP, and a floating exchange rate regime. The main theoretical features of ITR model in Brazil are the following (Arestis et al., 2011):

(i) Price stability is monetary policy' primary long-term objective. In addition, at least theoretically, the price stability goal may be accompanied by output stabilization;
(ii) Fiscal policy is no longer viewed as a powerful macroeconomic instrument for stabilizing the economy. Thus, the economic authorities introduced, in 2000, the Fiscal Responsibility Law to improve fiscal discipline in all government entities (Union, states and municipalities). In other words, it was created a fiscal target in terms of a primary budget surplus to aim at stabilizing the debt-to-GDP ratio;
(iii) The level of economic activity has to fluctuate around a supply-side long-run equilibrium. This means that the level of effective demand does not play an independent role on the long-run level of economic activity;
(iv) Finally, considering that the Brazilian economy is open, with a history of external imbalances and payment crises, to avoid that exchange rate can transmit shocks to interest and inflation rates, the CBB signals a clear commitment to price stability under a floating exchange rate system.

Focusing on the monetary policy, the interest rate target is set by the Monetary Policy Committee (COPOM). The basic interest rate that the COPOM seeks to influence is SELIC, an interest rate for overnight interbank loans, collateralized by those government bonds. The interest rate target is fixed for the period between the COPOM regular meetings (every 45 days). The President of the CBB, though, has the power to change the SELIC interest rate target anytime between regular COPOM meetings. Immediately after the COPOM meetings, the CBB publishes an Inflation Report, which provides specific information on economic conditions, as well as the COPOM's inflation forecasts upon which changes in the SELIC are determined.

Table 1 below shows the point targets, the tolerance intervals, inflation rates, measured by the effective headline Consumer Price Index (IPCA in Brazil), annual interest rates (nominal and real) and annual growth rates from 1999 to 2020.

Table 1. Targets, Tolerance Intervals, Inflation (IPCA) Rate, Nominal and Real SELIC and GDP Growth Rate, %, from 1999 to 2020

Year	Targets	Tolerance Intervals	Inflation (IPCA)	Nominal SELIC[1]	Real SELIC	GDP Growth Rate
1999	8	6 to 8	8.94	19	9.2	0.5
2000	6	4 to 8	5.97	15.75	9.2	4.4
2001	4	2 to 6	7.67	19	10.5	1.4
2002	3.5	1.5 to 5.5	12.53	25	11.1	3.1
2003	4	1.5 to 6.5	9.3	16.5	6.6	1.1
2004	5.5	3 to 8	7.6	17.75	9.4	5.8
2005	4.5	2 to 7	5.69	18	11.6	3.2
2006	4.5	2.5 to 6.5	3.14	13.25	9.8	4
2007	4.5	2.5 to 6.5	4.46	11.25	6.5	6.1
2008	4.5	2.5 to 6.5	5.9	13.75	7.4	5.1
2009	4.5	2.5 to 6.5	4.31	8.75	4.3	- 0.1
2010	4.5	2.5 to 6.5	5.91	10.75	4.6	7.6
2011	4.5	2.5 to 6.5	6.5	11	4.2	4
2012	4.5	2.5 to 6.5	5.84	7.25	1.3	1.9
2013	4.5	2.5 to 6.5	5.91	10	3.9	3
2014	4.5	2.5 to 6.5	6.41	11.75	5	0.5
2015	4.5	2.5 to 6.5	10.67	14.25	3.2	- 3.5
2016	4.5	2.5 to 6.5	6.29	13.75	7	- 3.3
2017	4.5	3 to 6	2.95	7	3.9	1.3
2018	4.5	3 to 6	3.75	6.5	2.7	1.3
2019	4.25	2.75 to 5.75	4.31	4.5	0.2	1.1
2020	4	2.5 to 5.5	4.52	2	- 2.4	- 4.1

Source: Author's elaboration based on Ipeadata (2021) and CBB (2021).
Note: (1) End of period.

Based on Table 1, we have the following considerations during over the 1999-2020 period: (i) the tolerance intervals were missed for four years (2001, 2002, 2003 and 2015); (ii) the inflation rate was over the target for 15 of 22 years; (iii) the inflation rate was high for countries that adopt a ITR – the average inflation rate was 6.3% per year; (iv) the nominal and real interest rates (SELIC) were high; (v) as it was shown on footnote 2, the average economic growth rate was only 2.0% per year; and (vi) for the entire period analyzed, there is not an inverse relationship between nominal interest rates and inflation rates.

Given that, it is possible to argue that monetary policy under the ITR in Brazil is ineffective to ensure lower and stable inflation rates, as well as it affects negatively the economic growth. Going in this direction, Modenesi and Araújo (2013) and Araujo et al. (2018), based on an econometric analysis of the monetary policy transmission mechanism in Brazil, endorses our claim that inflation is not directly sensitive to the interest rate,[6] while Libanio (2010) argues that the way that monetary policy has been conducted in Brazil under the ITR, with a floating exchange regime and a liberalized financial account, brings about an upward bias in interest rates that reduces aggregate demand and, as a consequence, the economic growth.

Summarizing this subsection, in Brazil, tight monetary policy and, as a consequence, high interest rate (i) have not been effective at reducing and stabilizing inflation,[7] (ii) have contributed to the poor performance of the GDP growth rate, and (iii) have transferred income to rentiers.

3.2. The rentiers' interest in the monetary policy[8]

The previous subsection stimulates us to the following question: Why does an economy require high nominal interest rates to achieve lower and more stable inflation rates? According to Dutt (1990-91), from a theoretical perspective, high nominal interest rates, mainly in emerging economies, are able to reduce inflation when capacity utilization is full. Going in the same direction, in *How to Pay for the War*, Keynes (1972) argues that when the economy has reached the full employment, tight monetary policy is important to reduce and stabilize the inflation rate.

Focusing on the Brazilian economy, considering that Brazil has a large amount of idle capacity, as well as the average GDP growth rates have been modest in the last 22 years, high interest rates, theoretically, are not a plausible explanation to mitigate and stabilize the inflation rate.

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[6] Exploring closely the idea that inflation rate is not sensitive to SELIC, Table 1 shows that from 1999 to 2005, despite high interest rates, the inflation rates were above the targets, as well as in three years the inflation rates were greater than tolerance intervals. In 2006, 2007 and 2008 it seemed that there is a negative relationship between interest rates and inflation rates, but, again, from 2009 to 2016 a tight monetary policy was not able to bring the inflation rates to their targets. Finally, from 2017 to 2020, the lowest interest rates of over period did not affect the inflation rates.

[7] Concerning this point, Arestis et al. (2011) show that the main causes of the Brazilian inflation rate are related to cost-push factors – such as movements in the exchange rate and changes in the international prices of commodities –, distributive conflicts and by partial inertia due to the indexation of the administered prices.

[8] The main arguments of this subsection are based on Ferrari Filho and Milan (2018a).

Given that, some new-developmentalist and post-Keynesian economists have an interesting view about the high nominal interest in Brazil.

For Bresser-Pereira and Gomes (2009), the interest rate is very high in Brazil due to an interest/exchange rate trap. Arestis et al. (2011) argue that the SELIC is high because the CBB is 'captured' by rentiers – by the way, this argument is similar to the CTA's idea that argues rentiers dominate central banks. Ferrari Filho and Milan (2018a) argues that high interest rates managed by CBB means the Brazilian version of the liquidity trap. Thus, according to them, monetary policy and high interest rates are operated by CBB to sustain the rentier's inflationary expectations, and, as a result, their income earnings.[9] Vernengo (2008) argues that the distributive conflict is important for the inflationary dynamics, and that indeed the monetary policy regime favors the financial sector interests within the rentier segment.

But how rentiers are able to shape monetary policy in Brazil? In other words, why do the rentiers have powerful in setting successful interest-income transfer program to them?

Bruno et al. (2011) show that the public debt, and the corresponding interest payments, is a major source of financialized capital accumulation in Brazil. Thus, it is possible to argue, based on this reasoning, that non-financial firms are also earning interest payments and are not opposed to high interest rates, being part of the rentier segment.

In our view, the influence of rentiers over monetary policy in Brazil, a very likely explanation for the stubbornly high interest rates, has more to do with an institutional setting in which central banks are structurally constrained to keep nominal and real interest rates high, but in Brazil this framework has favored the rentier class on an unseen scale, with the result that monetary policy is ineffective in reducing and stabilizing inflation rates to the international average levels, but very effective in transferring income to rentiers.

[9] Going in this direction, Erber (2008, p. 623-624) points out that the tight Brazilian monetary policy is the result of a coalition of interests [that] was formed, structured by the public debt and the high interests earned on such debt. This coalition operates under a tacit agreement that the Brazilian State has to pay high interests and so must do other debtors. Thus, there is a convention firmly grounded on powerful interests, historically consolidated, about the payment of interest rates. More specifically, this means that interest rate depends on the expectations of the financial markets, despite the fact that the monetary authorities controls the monetary policy.

The CBB sets the short-term interest rate based on a survey of expected inflation mostly by financial institutions. Many issues seem to affect those expectations. For instance, despite the fact that the central government has never defaulted on its domestic debt, financial institutions seems to assume that the risk of default is permanently high, and therefore the interest rates must be kept at high levels in order to finance government deficits. This is an example of expectational trap.

The rentiers also seem to assume that monetary policy has not been credible, and expected inflation is rigid on the upper levels, even when actual inflation slightly falls. The solution is therefore to jack interest rates up even more. Inflation does not fall fast enough? Jack up one more time. If interest rates do not drop it is because inflationary expectations are rigid due to the lack of true commitment with lower inflation rates. That is, a possible interpretation of rentiers power over monetary policy is that inflation rates do not fall in Brazil because expected inflation by financial firms, whose services have a small participation in the IPCA, are rigid, and they are rigid because interest rates are kept unduly low, even though they are among the highest one in the world. Interest rates, according to rentiers in general and financial firms in particular, only reflect the lack of credibility of monetary policy, and they are the only ones capable of defining what is credible and what is not. Credibility is defined as what financial firms think it is or, in our interpretation, whatever policies favor financial interests. If financial firms do not accept a policy, it is not credible by definition (Grabel, 2003).

Therefore, a consequence of their likely view is that expected inflation fully determines actual inflation rates, and the former do not fall because real interest rates are not high enough. But since interest rates also measure the rate at which capitalized monetary and financial wealth grows, it is our argument that and rigid expected inflation rates have a major consequence in the form of transfer of funds from the government to the rentiers whose expectations anchor the policy decisions by the CBB. So, it is highly convenient to have expectations disconnected from actual rates of inflation. It would certainly be outrageous for orthodox economists, mainly the ones working for the rentiers, if a rule of wage-setting was established such that nominal wages were automatically adjusted based on the workers and trade unions own inflationary expectations, surveyed by the CBB. But that is exactly what rentiers have accomplished themselves in Brazil. Thus, the expectations of rentiers seem to have transformed the ITR into an expectational trap, a powerful mechanism to sustain high

interest rates (and earnings) in Brazil even though it has not had significant impacts on actual inflation rates, since they are not sensitive to credit-financed demand.

Ferrari Filho and Milan (2018b) proposes a theoretical classification for the different combinations of nominal interest and actual inflation rates as a way to interpret the structure of monetary policy. The abnormal power of rentiers in Brazil in setting the monetary policy makes it hard to classify the country using this scheme, however, since interest rates in Brazil are very high, but the inflation rates are not low for international standards (although they are not higher than the ones prevailing in many countries in our sample). The recent episode in Brazil, when public banks were enticed to boost competition and reduce market interest rates, along with policy rates reductions by the CBB, is telling in this respect. It led to all types of financial 'revolts' in the Brazilian press, including the financialized industrialists. This episode deserves a deeper treatment that is beyond the scope of this chapter, since it raises the question of why and how the attempt at monetary policy change failed, and the potential role that rentiers' interests played in it besides the public opinion channel.

Yet, the Brazilian anomaly of an expectational trap seems more close to a case of rentiers' party, with excessive real interest rates based not on low inflation, but instead on exorbitant nominal interest rates, whereas other countries seem to have managed to subdue rentiers' interests, for some reasons that must be addressed by additional research, with nominal interest rates closer to the inflation rates and therefore closer to Smithin's rule of zero real interest rate (Smithin, 1996).

To conclude, it is hard to defend ITR in Brazil as effective in achieving its stated goals. Considering the international standpoint, real interest rates have been excessive on several grounds, despite a fall during the center-left government (that has not led to uncontrolled inflation, as predicted by the NCM defenders), but not enough to bring it down to the international average. Thus, in Brazil CBB should be labeled irresponsible for maintaining very high nominal and real interest rates, with no trivial burdens on the nominal budget deficits (Weisbrot et al., 2017). In this case, the fiscal 'irresponsibility' is more likely a side effect of an 'irresponsible' monetary policy. This policy is wasteful regarding GDP growth and decent employment policies when compared to other countries, although it is still profligate regarding the rentiers' interests well served by this very monetary framework of unnecessary transfers from taxpayers.

4. Conclusion

As it was shown in this chapter, ITR in Brazil, despite Brazil has one of the highest average nominal and real interest rates, does not seem to be effective in fulfilling its official objectives of keeping low and stable inflation and contributing to sustainable economic growth and low unemployment rate, as expected by original NMC approach. Moreover, as footnote 3 showed, the CBB reaction to inflation has been asymmetric: (i) the increase in the inflation rate generates a more than proportional reaction of the SELIC; and (ii) CBB reacts very gradually (it means, it reduces the SELIC very slowly) when there is a fall in the inflation rate and/or a sharp reduction in the output growth.

Thus, it may be concluded that ITR in Brazil was not completely successful over the period 1999-2020.[10]

Given that, it is possible to argue that monetary policy in Brazil has been very abnormal. That is, on the one hand, SELIC does not reduce inflation because there is no excess of demand – as it was argued, the Brazilian inflation seems to have different determinants, including external transmissions, distributive conflicts, supply shocks and inertia mechanism –, and, on the other hand, high interest rate has stimulated transfer payments in the form of nominal budget deficits to the rentiers, once they earn what they expect to earn in the current monetary framework – more specifically, the expectations trap that frame the monetary policy, in which the CBB overemphasizes the inflationary expectations of rentiers for defining interest rates, contribute to the power of rentiers over monetary policy.

To conclude, if Brazil aims at achieving price stability, low unemployment, and sustainable and robust economic growth, the ITR does not seem to have been the answer. To achieve this objective, according to Rochon and Setterfield (2008), it is necessary an alternative rule of setting the interest rates to aim at reducing inflation, boosting GDP and employment growth, and minimizing income and wealth concentration. This idea is consistent with the Keynes' idea of 'the euthanasia of rentier', as it was mentioned before. However, of course, this is likely to be met with strong resistance from the Brazilian rentiers' interests.

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