Restructuring the Economic Policy Framework in Brazil: genuine or gattopardo change?

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Abstract

Since the WW II, two development conventions have been disputing hegemony in Brazil: a *pro-growth – state led* and a *pro-stability – free market* conventions. Until the 1970s, the so called "developmentist" convention was hegemonic, and in the 1980s the stability convention started ascending. The rise of neoliberalism in the 1990s, reinforced the precedence of stability over growth. In 1999, a new economic policy (EP) was adopted based on the *tripod*: inflation targeting; floating exchange rate; and budget surplus targeting. Aligned to the *New Consensus in Macroeconomics*, it counts solely on the interest rate to control inflation. Until the global crisis, it was paramount. But, it locked Brazilian economy in a trap: low growth; high interest rates; relatively high inflation; and overvalued currency. Under Lula and mainly under Dilma's term, EP has been changing attempting supporting growth. But it does not mean a true inflexion in the EP far less the adoption of a Keynesian one. The change is Palley's *gattopardo* change: "change that keeps tings the same". The new measures left untouched the essence of the 1999 adopted EP. The changes only mask the orthodoxy of EP. So, it is troublesome arguing the process of formation of a new hegemonic development convention is under way.

Keywords: Convention; Development Conventions; Economic Policy; Brazil
JEL: E50; E60; E61; E65; G28; O54

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1. Introduction

Since the World War II, two development conventions (DCs from now on) have been disputing hegemony in Brazil: a *pro-growth – state led* and a *pro-stability – free market* convention. Until the 1970s, the so called "developmentist" convention was hegemonic, and in the 1980s the stability convention began its ascent reinforced with the surge of neoliberalism in the 1990s.

Under President Cardoso, a new economic policy (EP) regime, aligned to the *New Consensus in Macroeconomics* (NCM), was adopted in 1999 based on the *tripod:* inflation targeting; floating exchange rate; and primary budget surplus targeting. [1]

It locked the economy in a trap: low growth; chronically high interest rates; relatively high inflation; and overvalued currency. To get out of it, timid attempts started in President Lula's second term (2007-10), and under President Dilma the process of change was intensified, involving fiscal, financial, exchange rate and capital, and even monetary measures.

But, the whole change was *gattopardo* change in the terminology of Palley (2013: 1): "change that keeps things the same". Being cosmetic, they left untouched the very essence of the EP.

This paper has four sections besides this introduction. Section 2 presents the concept of development convention and its application to the case of Brazil after WW II. In section 3, is firstly summed up the tripod's main goals and some quantitative results and, secondly, is detailed the measures that eased it, mostly under President Dilma. Section 4 gives an overview of the change in the EP framework as a whole and also introduces Palley's concept of *gattopardo* change to eventually argue that Dilma's policy, though somehow differentiated from that prevailing during 1999-2007, does not fulfill the necessary condition to the rise of a hegemonic DC. Our final remarks are in section 5.

2. Development conventions and economic policy in Brazil
2.1. The concept of development convention: Erber's contribution

With a rather practical view, Salais (1989: 213) has suggested that "[t]he etymology of the word helps to precise what we should understand, generally speaking, by convention. Convention comes from the Latin word *conventio*, originated itself from *convenire*: to come together, and in a figurative sense to be in accordance". [2]

With similar grasp of French Convencionalists (FC), Erber has conceptualized convention as a "*heuristic device* for dealing with *uncertainty*", in the Knight-Keynes sense, as far as it provides socially shared "*guiding rules*" necessary to structure individual expectation and behavior, thus reducing inergodic uncertainty and inducing economic or social coordination. Rules that establish "*positive* and *negative agendas*" [as suggested by Lakatos (1970)] which set up "a *hierarchy of problems* (e.g. inflation control, income distribution) which must be tackled", and discern "*solutions* to such problems which are *acceptable* (e.g. inflation targeting) or *not* (e.g. administrative price controls), organizations in charge (e.g. Central Bank), as well as rules and regulations (e.g. Basle banking rules)". And eventually a *teleology* that, giving "coherence" to the guiding rules, strengths their guiding power by means of a "historical metaphor – a story, a theory, which explains how the present arouse out of the past and, especially, how the future will be if the rules are followed" (Erber, 2004: 40; 2012: 7-8; our emphasis).

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[1] The emergency of the New Consensus on Macroeconomics (Blinder, 1981; 1997; Taylor, 1993; 2000; Allsopp e Vines, 2000; Romer, 2000) is associated with the growing popularity of inflation targeting and the resulting acceptance that, even where the regime is not adopted, the main instrument of monetary policy is the interest rate, and no longer the monetary aggregates of three decades ago, influenced by Friedmanian monetarism. The new consensus theoretical core is giving by the confluence of monetarism, new classical and real business cycle theory. The natural rate of unemployment and rational expectations hypothesis are among the two most relevant assumptions shared by this large group of economists (Lavoie, 2004; Setterfield, 2004; 2005; Arestis and Sawyer, 2004; 2005; Fontana and Palacio-Vera, 2002; Setterfield, 2004; 2005; 2006). Another fundamental part is the *Taylor rule* – which holds that the central banks should determine its interest rate aimed at an explicit or implicit inflation target, and at keeping GDP growth near to its potential. We agree with Lavoie that "the only truly new element in the new consensus (...) is the rejection of the exogenous supply of money, and the replacement of money growth rule for a real interest rate targeting rule (…)" (Lavoie, 2004: 23).

[2] According to Dictionary *Le Robert*.

Erber (2012) has remarked that a convention is an authentic social phenomenon transcending individual actions or judgments of the social actors participating of its formation, who nevertheless are eventually affected by it. A convention is a pattern of behavior or judgment constituted by the interaction of social actors each of whom trying to take a decision or to form an expectation under inergodic conditions.[3]

As Dequech (2003: p. 146) has pointed out, "different concepts of rationality and convention have been used by different economists (…). Despite their conceptual differences, these economists have something in common: (…) they all tend to focus on the rationality of following a convention (or a rule or the like)".

Erber has also been influenced by the French school of regulation and applied its concepts and theses to the analysis of the *pattern of development* in Brazil – a key factor to understand the meaning of DC.[4] He defines pattern of development as a "(…) set of **relations** between **economic and social agents** that ensure, for a given period of time, the continuity of the **processes** of **capital accumulation** and the **preservation of political power**" p. 8; our highlights; our translation). In the economic dimension, these relations are translated into a set of *standards* regulating: accumulation; production; consumption; funding; innovation and diffusion of technology; State intervention; and international insertion.

Erber's concept of convention is in line with the notion of *Mode de Régulation* [Mode of Regulation]. Boyer and Saillard (2002: p. 41) state that "a mode of regulation establishes a set of procedures and individual and collective behaviour patterns which must simultaneously reproduce social relations through the conjunction of institutional forms which are historically determined". Agents are involved by series of institutional arrangements that socialize and restrict both information and cognitive abilities, adopting situated rationality. It ensures compatibility of a set of decentralized decisions, without requiring agents to internalize the principles governing the overall dynamic of the system (Aglietta, 1997). Modes of regulation may differ, depending on time and location, and evolve as a result of the interactions of its institutional forms (Benassy *et al.,* 1979).

FC and Erber have all of them taken as departure point the pioneer employment of the concept of convention in the economic field by Keynes (1936)[5]. FC have innovated by proposing the convention occurrence in a new set of economic areas, e. g. in the work market. Later on, Erber has also made an original contribution by formulating a concept of *development convention*.[6]

Keynes (1937: 214) – where the author "most extensively discusses the following of conventions under uncertainty" (Dequech, ibid.: p. 148) – proposes that we follow a *conventional judgement* (or behavior) when "we endeavor to conform with the majority or the average" – not necessarily with all the members of the whole society. This allows Dequech (ibid., p. 147) to simply say that "conventions are usually thought of as involving several people", or else a "given population" within a society (Dupuy, 1989).[7] Being so, the coexistence in a given society of a plurality of conventions about a same social-economic matter is always possible.

Erber (2008a, 2012) has formulated the concept of *development convention* founding it in a rather comprehensive and didactical conceptualization of convention itself which encompass FC's contributions as those made by Dupuy (1989) and Orléan (1989). Therefore it seems to deserve being entirely reproduced here:

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[3] A similar point of view: "convention is a regularity that has its source in the social interactions but that presents itself to the actors under an objectified form" (Dupuy et al., 1989: 145; our translation).

[4] In 2008 Erber spent some time in the Centre d'Economie de Paris Nord (at Université Paris 13), doing a research on development theory and political economy.

[5] Modenesi *et al*. (2013a) analyzed Keynes's and FC's convention approaches. For them, Keynes "has presented concepts of convention, examples of convention and of conventional judgment (or behavior), but has never translated its content into a formalized expression, for good or evil" (ibid: 77). See also Dequech (2011). For Davis (1997: 130), Keynes would have deepened his convention treatment if he had written a "second edition *The General Theory*".

[6] See Carvalho (2013), Lautier and Moreau (2012), and Thury and Freitas (2010).

[7] This is also the understanding of Salais (1989: 213): "[a] convention is a set of elements that – *for the participants of the convention* – go together all the time, and about which they share a common agreement" (our translation and emphasis).

> Such set of rules, the positive and negative agendas they generate and the teleology underlying them are a **convention** – a collective representation which structures individual expectations and behavior (Orléan, 1989), in the sense that, given a population P, we observe a behavior C which holds the following characteristics: (1) C is shared by all members of P; (2) every member of P believes all other members will follow C; (3) such belief provides members of P with a sufficient reason to adopt C Orléan (2004)[8]. A convention arises out of the interaction of social agents but it is external to such agents and cannot be reduced to their individual cognition, i.e. it is an emergent phenomenon (De Wolf and Holvoet, 2005). In every society there are many conventions dealing with different aspects of economic and social behavior (e.g. quality of traded goods, the working of the financial system). Following our definition, a **development convention** is concerned with structural change. This begs the question about which "structures" are to be changed? The answer to that question differentiates development conventions (Erber, 2012, p.8; italics in original).

Let' emphasize that a convention is a "social representation" (Jodelet, 1989) embodying the necessary "beliefs" or "cognitive content" that together with the "political and economic power" of the population adherent to it are the determinants of its "strength and evolution" that, by its turn, enables the convention to subsume and to determine the individual judgment (or behavior) (Erber, ibid.: 8).

It is also worth remarking that, as development is related to long term structural changes, development convention formation correspondently is a time consuming process, as far as people's adherence to it only progress to the extent that it is being implemented and its expected results are popping up. So that its agenda (and teleology) is working, i. e. convention's promised achievements are being showed. Or, metaphorically: as far as the Promissed Land is perceived by the population as being nearby. It usually takes a long way for a development convention be established and eventually becoming hegemonic.[9] Of course a hegemonic development convention may coexist with other(s).

Summing up, development conventions do exist as a direct result of the concept of economic development itself. The structural changes subjacent to and characteristic of the development process produce inergodic uncertainty, as well as coordination problems. DC convention operates mitigating the uncertainties and providing the pertinent coordination required by the development process.

2.2. Development conventions in Brazil

The *developmentist* convention was hegemonic from the end of WW II to 1970's. Accordingly, development should be fostered by promoting structural changes under the leadership of the state. Its ideological and technical content was mainly provided by the UN Economic Commission for Latin America (ECLA) diagnosis that underdevelopment was the counterpart of the process of evolution of capitalism. In line with the *structuralist* (or *center-periphery*) *approach*, the world was divided in a developed center and an underdeveloped periphery (Prebisch, 1949). Promoting industrialization was considered a necessary condition to foster development. It also included in its agenda the removal of bottlenecks in economic infra-structure, agriculture modernization, and the eventual bettering off people's economic and social conditions.

Most of ECLA's propositions were inspired by the innovative Keynes's *General Theory* and by the previous "Anglo Saxon structuralism".[10] Promoting the aimed structural economic-social changes

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[8] The author that should be referred to is not Orléan (2004), but Dupuy (1989), whose original definition of convention is partially utilized here by Erber.

[9] As Keynes (1936) has explained a convention may be short or long-lived.

[10] Comprising "pioneers of development" according to Sanchez-Ancochea (2004): Rosesenstein-Rodan (1943), Nurkse (1953), Lewis (1954), Myrdal (1957). A major background influence was Karl Marx's, but was also important Rosa of Luxemburg's and Joan Robinson's. Furtado (1979) presents "Marx's model" of capitalist development, underlining that, as a revolution, "Marx behold capitalism mainly from the standpoint of its whole dynamics, of its 'internal contradictions', of its historical dimensions, of its beginning and ending' (1961: 32; our translation). Telling about his youth, Furtado (1985: 21; our translation) asked "[h]ow not repudiating an economic system to which instability should attribute the emergence of fascism and of an odious war?" to answering: "[w]ell, Marxism seemed to be the sole doctrine that promised a stable world, without unemployment and the rentable weapon business". He also tells that Emmanuel Mounier once said to him: "Marxism, in a hundred years, was slain verbally more than the Christianity over centuries and yet its impact on human conscience remained as strong as ever" (ibid.: 21; our translation).

should be fulfilled by means of direct indirect state intervention: public enterprises, public investment, planning and incentives to private investments.[11]

One of the State's tasks was imposing quantitative controls and high tariffs on the import of consumer goods and easing that of intermediary and capital goods considered as essential ones to industrialization. This pattern of industrialization turned to be known as "import substitution", as explained by Tavares (1964) (see Bielschowsky, 1988).

Structuralism provides the teleology of developmentist convention as far as it explains how underdevelopment was originated and how it can be surmounted. It also provides the shared guiding rules to coordinate economic agents' expectation and behavior and then reducing uncertainty and inducing economic and social coordination. Those rules allows to specify positive and negative agendas which establish a hierarchy of problems to be solved (e.g., the deficiency of the industrial sector, the infra-structure bottlenecks), and design acceptable solutions (e.g., import substitution, public investment in infra-structure) and discharge non-acceptable solutions (e.g., reduce growth to control inflation). The convention also indicates the organizations responsible to achieve each goal and finally the rules and regulations that will govern the targets implementation.

Price stabilization was not a goal, and some expected changes were not carried out. For instance, the improvement of the income distribution, land reform, labor legislation modernization, and scientific and technological area did not receive the adequate support. In few words, the developmentist convention was adopted only in a *restrict* version. For instance, President J. Kubitschek was elected with the slogan "fifty years [of development] in five years". Indeed, during his administration, GDP growth rate was around 8% p.y and inflation reached 22% p.y. Nevertheless, he was viewed as a most prestigious president.

The priority given to economic growth was even furthered by a right wing military coup in 1964 (Furtado, 1985). For the period 1946-79, economic performance has no parallel in Brazil's history: GDP growth rate was 7,6% p.y, and the industrial product share in the GDP rose from 23% to 33%. Nevertheless, inflation accelerated progressively from 19% to 67%, and income distribution worsened (Gini coefficient increased from 0.535 to 0.589, from 1960's to 1970's).

After the 1970's, the pattern of development in Brazil began to be radically changed. During the "lost decade" (1980s), economic growth vanished drastically, external debt grew up to the point of generating a debt and a fiscal crises, inflation went out of control and – due to its regressive effects income distribution – disturbed the functioning of economic system.

Those bad results gave rise to a cumulative process of deconstruction of the developmentist convention. On the other hand, in the wake of the global loosing of prestige of the Keynesian theory, the Washington Consensus appeared with a new neoliberal agenda – to be worldwide promoted and even imposed by the IMF and the World Bank – including fiscal discipline, privatization, deregulation, and current and capital accounts liberalization. It also brought a new teleology: liberalization would pave the way for development.

From 1985 to 1994, six stabilization plans failed to control inflation. During Collor's administration (1990-92) a privatization and liberalization processes were adopted. Only in 1994 the Real Plan (based on an exchange rate anchor) has finally brought prices under control. During Cardoso's terms (1995-2002), the Washington consensus agenda was furthered and the stability convention eventually became hegemonic.[12] Privatization and capital account liberalization was deepened. State intervention was reduced substantially in favor of free market operation. Economic growth became secondary – or at best, a byproduct of price stability.

In 1999, the exchange rate anchor was abandoned in favor of the tripod policy comprising inflation targeting (IT); floating exchange rate; and primary budget surplus targeting. Aligned with the New Consensus on Macroeconomics it turned monetary policy the sole object of economic policy attributing to fiscal policy the supporting role of not creating inflationary pressures.

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[11] According to Furtado (1985: 103), "CEPAL's ideas armed ideologically opponents of liberalism: industrialization was the only way to proceed with development" (our translation).
[12] More details on Sallum (2000).

Nevertheless, the tripod locked Brazilian economy in a trap: low growth; chronically high interest rates; high inflation relatively to developing countries; and overvalued currency.

In Lula's second term (2007-10), but mostly under Dilma attempts to get out of this trap have been tried. This process gained momentum in the aftermath of the 2008 global financial crisis. Since then the global financial crisis, the neoliberalism has been put under questioning and so it has seen its hegemony being threatened worldwide, as far as orthodox theory and policies have been unable to handle with the new macroeconomic challenges.

3. The economic policy and its recent easing

In this section is first briefed on going Brazilian EP making short references to the Real Plan, its remote origin, making a brief balance, mostly quantitative, of its main results and pointing out some problems related to its implementation. Secondly, it is described in some detail a considerable set of economic measures, taken mostly under President Dilma, which has somehow differentiated the EP prevailing before the 2008 international crisis from the one still going on today. This section paves the way to answering, in the following sections, why the change in EP as a whole cannot be considered as providing a new agenda to the eventual emergency of a new dominant DC.

3.1 The economic policy tripod: main goals and results

The major problem of Brazilian economy in the 1980's and early 1990's was an uncontrolled process of high inflation. Both heterodox and orthodox economists agreed that inflation had become inertial, as far as the population had incorporated the inflationary memory: prices were indexed to the inflation of the previous period. With the adoption of the Real Plan in 1994, inflation was put under control at low levels (Fig. 1).

Figure 1: Yearly Inflation Rate (IPCA)
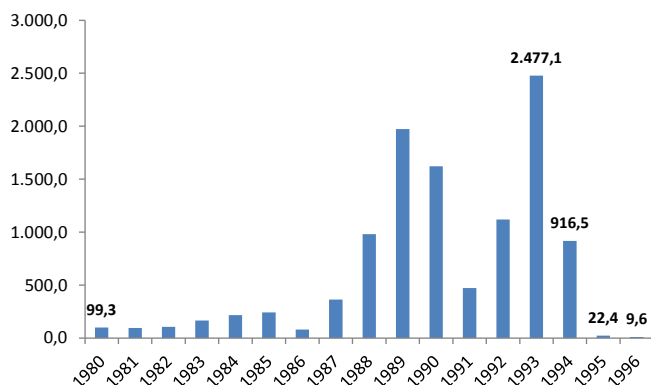
Source: IBGE

The Plan introduced a nominal exchange rate anchor sustained by excessively high interest rates, which attracted foreign capitals (Hermann, 1999). In the late 1990's, with the crises of Asian emerging countries this strategy was turned unsustainable. Capital outflows prompted speculative attacks against the real (Figure 2). The lattermost speculative attack occurred in September of 1998, when the balance of payments registered a net outflow of US$ 21.8 billion (see red arrows in Fig. 2) and international reserves fell 32.0%, from a level around US$ 70 to a level around US$ 40 billion.

**Figure 2: Monthly (net) result of the Brazilian balance of payments (US$ Million)**
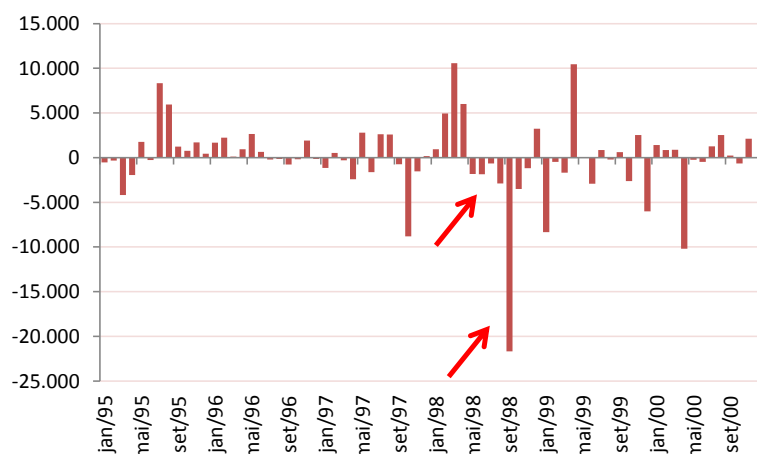
In 1999, a new framework entered into force, based in the so called the economic policy *tripod*: 1) inflation targeting regime; 2) floating exchange rate, with high capital mobility; and 3) primary surplus surplus targets. Price stability was pursued by fixing the basic interest rate according to a Taylor rule, controlling simultaneously aggregate demand and, though not directly, the exchange rate, in line with the NCM. Fiscal policy, in its turn, was kept flat, not to exercise pressures on public debt and inflation (through demand). Economic growth was left in a secondary place.

The results of this policy, still running nowadays, have been far from satisfactory. In a broad view, inflation was kept under relative control in the mid 2000's, but presented a sort of resilience impeding the inflation rate to go below a floor limit (Fig. 3). There are two main reasons for that. The domestic one is the fact that the practice of price indexation was not eliminated. In fact, relevant prices remained indexed to the past inflation, even under the terms of legal rules, such as rents, some tariffs (public transportation, energy, gas, etc.) and the called 'monitored" prices.

Figure 3: **Inflation (IPCA) accumulated in 12 months (%)**
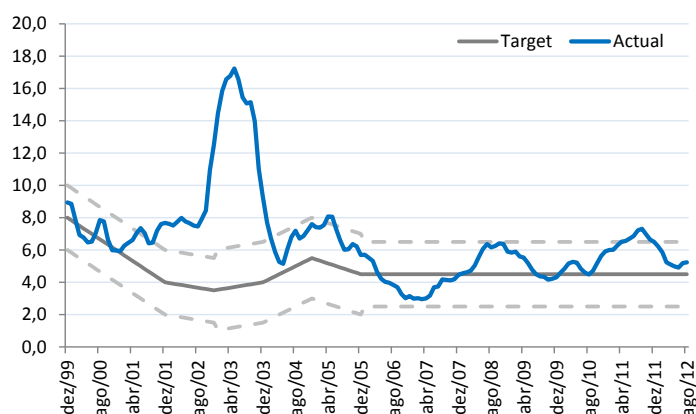
Source: IBGE and BCB.

So, any shock on agricultural prices, for instance, would spread to the whole economy. Administrated inflation (weighing one third of the general index)[13] drove inflation rate until the early 2007.

The external reason is the financialization of commodity markets (UNCTAD, 2009) and the emergence of China and India as big importers, commodity prices rose sharply. So, international prices contributed to put pressure in the domestic inflation along the 2000's.Then, currency appreciation became the main instrument to fight against 'imported' inflation, compensating tradable-commodity price rises in reais.

The strategy to control inflation led to two main problems still affecting the performance of EP: the high interest rates and the overvaluation of the real.

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[13] However not all administrated prices are necessarily indexed to past inflation.

The first one: monetary policy during the 2000's was rather conservative (Nakano, 2005 and 2006; Erber, 2008a, 20008b and 2011; Modenesi, 2011; Oreiro, 2012; Modenesi et al., 2013b). Extremely high basic rates were used to keep the real overvalued, what mostly explained the slowdown of inflation rates (see, for instance, Araujo and Modenesi, 2013). The conservatism resulted from the way BCB conducted the monetary policy, i.e. based on a strictly rigid Taylor rule in line with the NCM (see Modenesi et al., 2013b). Brazilian basic interest rate was too high even when compared with other developing countries (Table 1).

Table 1: Basic interest rates of selected countries

|	2005	2006	2007	2008	2009	2010	2011	Latest*
Brazil	18,0	13,3	11,3	13,8	8,8	10,8	11,0	7,5
India	6,3	7,0	7,0	6,0	4,3	6,3	8,5	8,0
Russia	12,0	11,0	10,0	13,0	8,8	7,8	8,0	8,3
China	5,6	6,1	7,3	5,3	5,3	5,6	6,6	6,0
Turkey	13,5	17,5	15,8	15,0	6,5	6,5	5,8	5,8
Mexico	8,3	7,0	7,5	8,3	4,5	4,5	4,5	4,5
Euro Area	2,3	3,3	4,0	2,5	1,0	1,0	1,0	0,8
United Kingdom	4,5	5,0	5,5	2,0	0,5	0,5	0,5	0,5
United States	4,0	5,3	4,3	0,3	0,3	0,3	0,3	0,3

Source: Trading Economics. *As of September 20, 2012.

The other problem was an overvalued exchange rate: the appreciation of the real was of 50% between end-2002 and 2010 (Fig. 4).The consequent loss of competitiveness (Fig. 5) .led to decreasing in the share of industrialized goods in the export basket, and to a process of de-industrialization (See Bresser-Pereira, 2010; Carvalho and Kupfer, 2011).

**Figure 4**: **Brazilian exchange rate (R$/US$)**
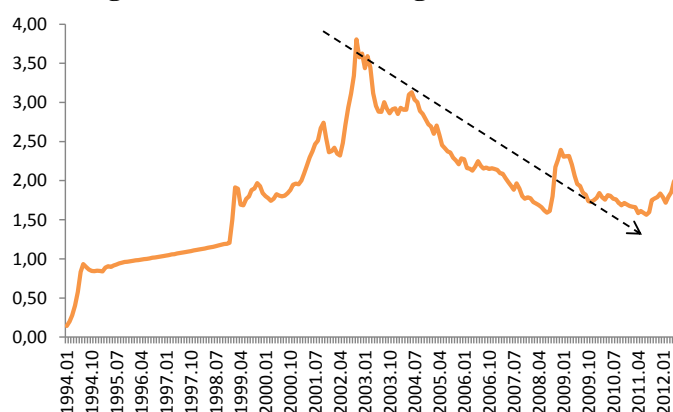
Source: BCB.

Figure 5: **Brazil Export Basket by type of goods (%)**
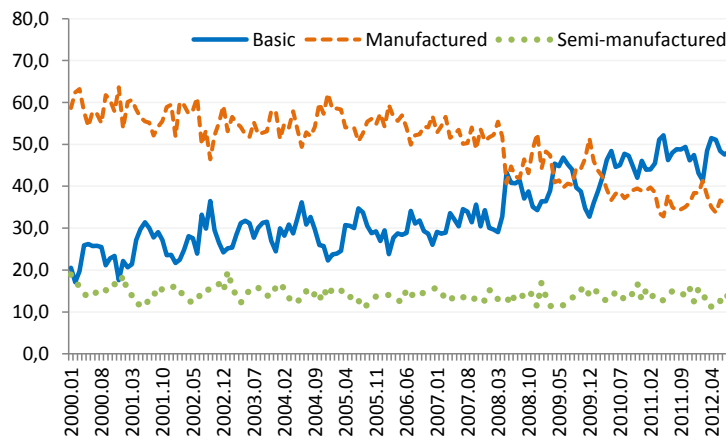
In sum, the tripod locked Brazilian economy in a trap. Despite of the extremely high interest rates and strong overvaluation of real, EP was not able to maintain inflation at expected reasonable level, and to promote satisfactory economic growth: GDP real rate of growth remained below the long-term average.

Figure 6: Brazilian GDP real growth rate (% a.a.)
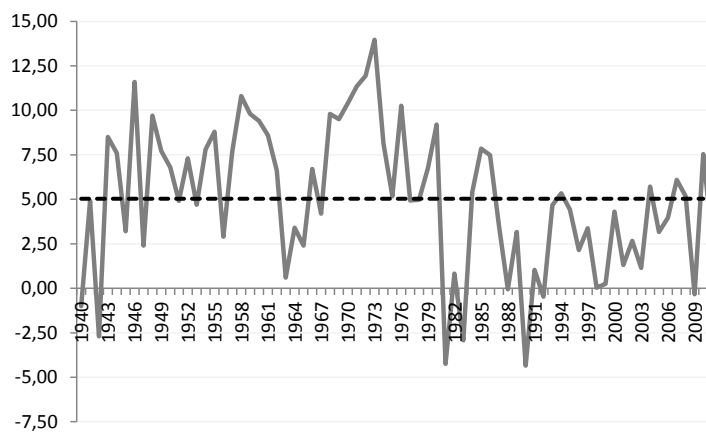
3.2 The economic policy easing

Her are presented the main changes in fiscal, monetary, financial and foreign exchange policies sheepishly started in the second Lula's term and becoming more significant under Dilma.

a. Fiscal Policy: fostering investment

The pursuit of high primary fiscal surplus targets did not allow using fiscal policy playing countercyclical role in the whole period. In 2003-2006, a great effort was done to increasing the surplus. Fiscal policy was used to offset the economic downturn following the subprime (2008-9) and the Euro crises (2011-2).

Figure 7: Brazilian Primary Surplus* (% GDP)

Source: BCB. * "Below the line" concept, i.e., calculated as the variation of the total net public debt.

Since the second Lula administration, some efforts have been implemented aiming at improving public investment levels. In 2007, was launched the "Plano de Aceleração do Crescimento-PAC" (Plan for Growth Acceleration"), designed to promoting investments in infrastructure and public services. The plan was only partially implemented being more successful its "Minha Casa Minha Vida" ("My House, My Life") program that has already built more than 2 million houses.

In 2011, Dilma inaugurated the "Brasil Maior" Plan, the first industrial policy plan since the end of the 1980s, aiming at fostering industry competitiveness and stimulating its exports. Its main measures were: restitution of taxes to firms committed to exports; preference to Brazilian producers in government's purchases; financing to R&D activities; and turning immediate the restitutions of taxes on capital goods purchases.

A more significant measure was edited in 2012. Forty industrial sectors, key to Brazilian development, were benefited with a shift in taxation. They were taxed at 20% on their payroll, now they are taxed at 1.00 to 2.00%, depending on the sector and on their gross revenue. This will represent a US$ 6 billion reduction on taxation in 2013, and the elimination of tax burden on employment, what is expected to increase employment and boost competitiveness in some relevant capital and durable goods industries. Besides that, in any industry the period of depreciation of capital assets was reduced from 10 to 5 years, in order to stimulate the purchase of new equipment and machines and, also, their production. The tax exemption due to this rule will amount to US$ 3.4 billion from 2013 to 2017.

In August 2012, Dilma announced a new version of the PAC plan which lays down public investment of US$ 66 billion in highways and railways, 40 billion in the next 5 years and 26 in the next 25 years. To carry out the investments and to regulate the transport systems, a public enterprise was created: "Empresa de Planejamento Logístico-ELP" ("Company for Logistic Planning"). This is Brazilian biggest plan in transportation, and it is expected to build 7,500 km of highways and 10.000 km of railways, and the bullet train connecting Rio de Janeiro and São Paulo. The plan is expected to reverse the tendency of highway network reducing.

Furthermore, electric energy prices, which were considered as one of the highest in the world, were significantly reduced: 16.2% on home consumption and from 19.7% to 28% on the industrial one. The reductions were held through energy suppliers tax burden reductions and the extension of their concession contracts. The government is now working aiming at promoting similar process of consumer price reduction in exchange of reduction on the tax burden of supplier of gas and also on items of the "cesta básica" (a set of basic consumer goods).

Those measures radically departure from the NCM *amendments*. They are in line with the structuralist view of inflation (Noyola, 1956; Sunkel, 1958). The basic inflationary pressures are related to structural economic system inflexibilities, as the inelasticity of supply of basic services and other inputs of widespread use, including some under oligopolistic condition.

b. Monetary policy

The first signals of changes in the conservative conduction of monetary policy started to be seen during the last six months of Lula's administration. In September 2010, the BCB decided keeping the basic interest rate unchanged (10.75%) while inflation expectations were deteriorating suggesting an inflation rate above the 4.5% target. This decision was put into force in the October and December meeting of the Committee of Monetary Policy board, when alternative measures started being taken.

Two main measures were taken. First, reserve requirements on deposits were raised to work as an alternative instrument to the interest rate in moderating the observed growth of aggregate demand, in order to control inflation.

Second, for the first time the BCB's Counsil of Monetary Policy (Copom) started adopting macro-prudential measures (set by the Basel Accord) by enhancing capital requirements on loans to individuals, especially, those for buying vehicles. However, the ascendant path of inflation and inflation expectations did not cease. Then, the BCB rose the basic interest rate five times in the first half of 2011.

In august 2011, the BCB decided cutting the basic rate from 12.5% to 12.0% despite of the raising of both inflation rate, and inflation expectations prevailing in the financial market.[14] This has been the first time under the inflation targeting regime that the BCB has not followed the financial market consensus, provoking doubts as: have the Taylor rule parameters changed? Was inflation targeting being abandoned? More than that, decision triggered rather virulent reactions from the financial market player, expressed through the media (Modenesi et al., 2012).

Figure 8: Figure 8: Basic Interest Rate (Selic)
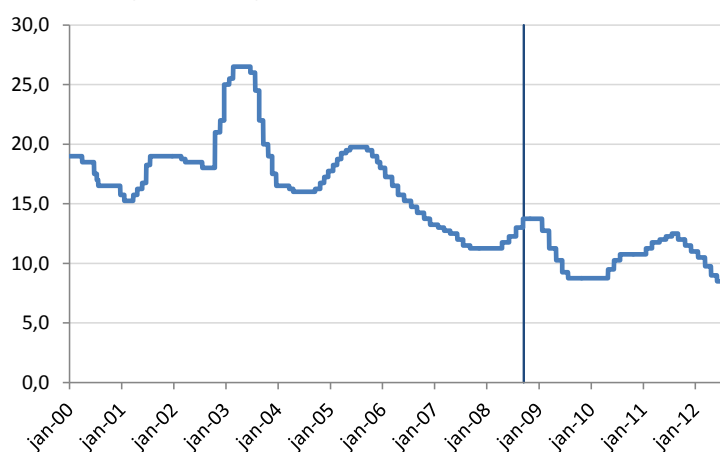
Source: BCB, the bar refers to Lehman Brothers collapse.

The Copom cut the Selic rate in eight subsequent meetings (Figure 8), making it achieving its lowest level since ever its creation, 7.5%, right a year after the first cut. So, Brazil scaled down the world ranking of basic rates from the 9th position to the 19th position, aligning its basic rate with the levels prevailing in other developing countries.

Thereby, one can state that the BCB's approach on monetary policy changed, mainly after August 2011. Nowadays, to control inflation the BCB has at hand the macro-prudential framework which can be used to pursue its main goal, when and whether it decided to do so.

c. Financial policy

The 2008 international crisis affected Brazilian financial and capital markets performance – but not the soundness of the financial system. Private bank drastically reduced the rhythm of loan concessions, as shown in Figure 9. Immediately, public commercial and development banks (bold line) aggressively expanded their pace of lending granting in order to reestablish the flows of resources for

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[14] According to the statistical survey carried out and published monthly by BCB itself in its own newsletter called "Focus" ("Focus").

corporations and individuals. In the second half of 2009, while private credit was growing at a rate around 5% in 12 months, public credit was increasing at a 30-35% rate. As a result, the share of these institutions in the credit market rose from 34.1% to 45.5% (Figure 10).

A second round of countercyclical action started in the end of 2011 and gained momentum in the first quarter of 2012 (Figure 9). This new round of public credit expansion represented an attempt to restoring consumption and economic activity levels, amid the economic slowdown.

The role of the two main public banks was redesigned: Banco do Brasil (BB) and Caixa Econômica Federal (CEF) started a crusade in favor of lower spreads, in April 2012. These institutions cut their interest rates, pressing private banks to do the same. After some resistance of the biggest private banks, spreads started to decrease as well as interest rates for clients. As shown in Table 2, BB and CEF cut around 4.0 percentage points in the spread of their main credit lines whilst bigger banks as Itaú Unibanco cut 8.0 p.p. and Bradesco 2.5 p.p. on loans to individuals[15]. According to President Dilma in a recent interview for Financial Times, "Brazil was the last free lunch in the world for the banks".
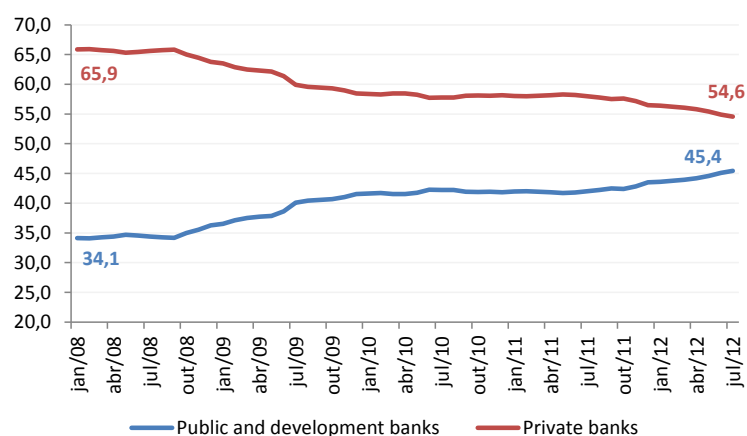
Figure 9: Overall loans growth rate by ownership of the bank (12 months %)
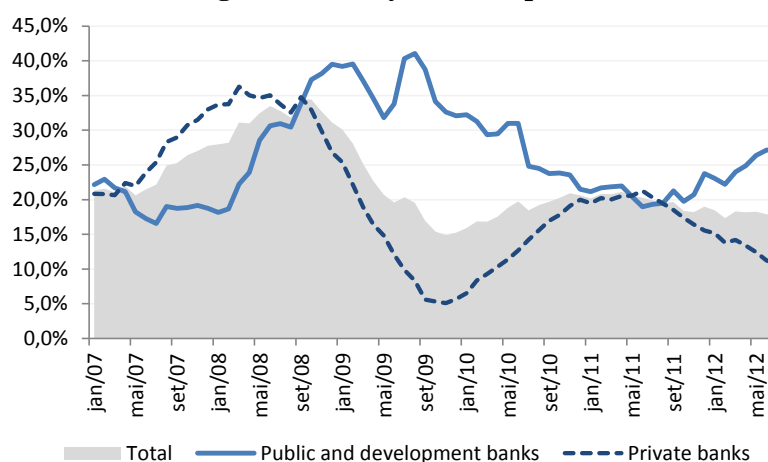
Source: BCB.

Figure 10: Loans by bank ownership (%)

[15] These cuts were not widespread yet as other private banks cut rates on lines that are less important to the bank portfolio.

11

Source: BCB.

Table 2: Average spreads on loans to individuals and working capital

	30/Mar-05/Apr		11-17/Sep		Δ*	
	Individuals	Working capital	Individuals	Working capital	Individuals	Working capital
BB	26,7	12,5	22,3	9,5	-4,4	-3,0
CEF	21,3	11,3	17,1	6,4	-4,2	-5,0
Itaú Unibanco	51,4	15,7	43,4	14,6	-8,0	-1,1
Bradesco	58,0	21,1	55,5	22,5	-2,5	1,3
Santander	39,4	11,9	41,1	32,1	1,7	20,2
HSBC	54,0	24,2	57,2	25,2	3,2	1,0

Source: Authors' elaboration based on BCB's data. Spreads were calculated by the difference between loans rates and the basic rate. *As a matter of comparison, the basic rate was cut in 2.25 p.p. during the same period.

Financial policies were not restrained to credit market. There is a clear attempt to create and develop a long-term capital market, especially a long-term corporate bond market. The government passed a law in 2011 that: (i) set tax incentives for foreigners invest in long-term bonds, and to domestic and foreign investors to invest in *infrastructure debentures*[16]; (ii) creates a special category of investment funds: *research, development and innovation investment funds*; (iii) improvements on *infrastructure investment funds*; (iv) eased conditions for issuers of debentures and financial bonds (ANBIMA, 2011b and 2011c; Freitas, 2011).

This measure was complemented by a joint initiative from BNDES and Associação (ANBIMA) called New Market for Fixed Income (NMFI), which resembles the BM&FBovespa New Market, and establishes differentiated corporate governance levels in the bond market. The adherence to NMFI is not mandatory but adds a kind of quality stamp to bonds issued under its rules. These rules include special conditions for terms, repurchase (allowed only 12 months after the issue), remuneration (banning indexation to Selic) etc. Besides that, they include "a set of measures aiming at support secondary market liquidity." (IMF, 2012b: 50).

Lastly and still regarding a long-term capital market, the structure of public debt remuneration has been changing in favor of pre-fixed bonds , which now is the main component and answers for 40% of the total (Fig. 11) public debt. Bonds with indexation to Selic – which actually reduces the bond's duration to zero with no risk discouraging private issuances – had its share reduced in 30 percentage points

In sum, together with the new measures of monetary policy, this measure helps establishing a benchmark for private long-term issues and eliminates the high-yield-no-risk condition of public bonds and the consequent unfair competition among these bonds and the private ones.

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[16] Debentures issued with the special purpose of implementing an infrastructure project, regulated by Decree 7603/2011.

Figure 11: Public debt - Share of indexers (%)
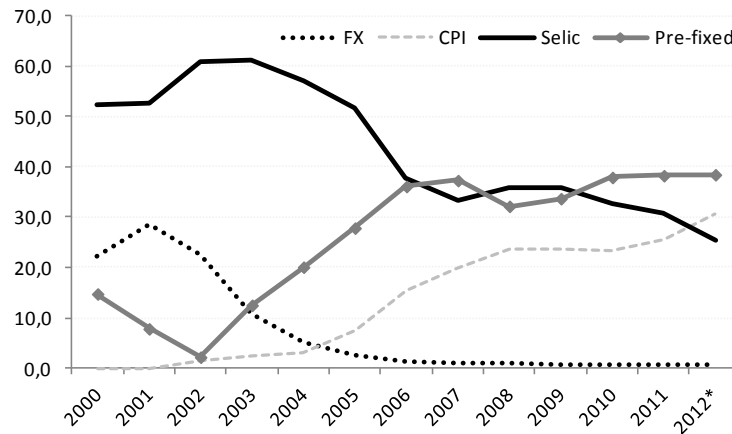
Source: BCB.

All the measures described in this section points to a deliberate attempt of the Brazilian government to improving the functionality of the Brazilian financial system aiming at financing economic development. Lower bank spreads and tariffs facilitate the access to credit and contribute to the soundness of the system from the financial fragility standpoint. A long-term capital market helps corporations funding their investments, improving the conditions for economic growth. However, one relevant caveat applies to the strategy designed for the capital market: there is a great reliance on foreign investors in developing this market, which has proved to be problematic in other occasions due to the volatility and pro-cyclicality of foreign capital flows, as has already happened in the Brazilian stock market (Hermann and Montani Martins, 2012).

*d. Exchange rate policy and capital controls*

After many years being considered undesirable capital control measures were once again used in Brazil in 2008. Massive inflow of short term foreign capital was appreciating too much the real. Then, a 2% rate of the IOF (a tax on financial transactions) was imposed to nonresident portfolio equity and debt inflows.

The crisis came and appreciation stopped, but in 2010, with the rebound of economic growth (7.5% GDP growth) and, mainly, after monetary expansion in developed countries (e.g., quantitative easing and operation twist in the U.S.), capital inflows accelerated once again, amounting to US$141 billion (6.8% of 2010 GDP). The rate of IOF was tripled from 2% to 6% but it was not sufficient to stop the appreciation of the real, as the IMF (2011: 35) diagnosed:

> [e]mpirical evidence suggests that the IOF measures did not have a clear, long-lasting effect on the exchange rate—at least relative to its level at the time the various IOF measures were introduced. This may have been due to the fact that the introduction of the IOF did not trigger a significant reduction in nonresidents' positioning in the futures market." (IMF, 2011: 35).

So, Finance Ministry started releasing several measures, intensifying capital controls and spreading them into several markets. The most important, taken in 2011, was the imposition of 1% of IOF on exposures in FX future derivatives betting against real (in line with IMF's diagnosis). It was improved and fine-tuned by three changes in end-February and March, 2012, when the Real rose to around R$ 2.00/US$. Figure 12 illustrates the path of Brazilian exchange rate with bars indicating the days when changes in IOF were introduced. Figure 13 shows the liquid position on exchange contracts signed for financial purposes (blue bars refer to the period after the futures derivatives measure).

Figure 12: Daily exchange rate (R$/US$)
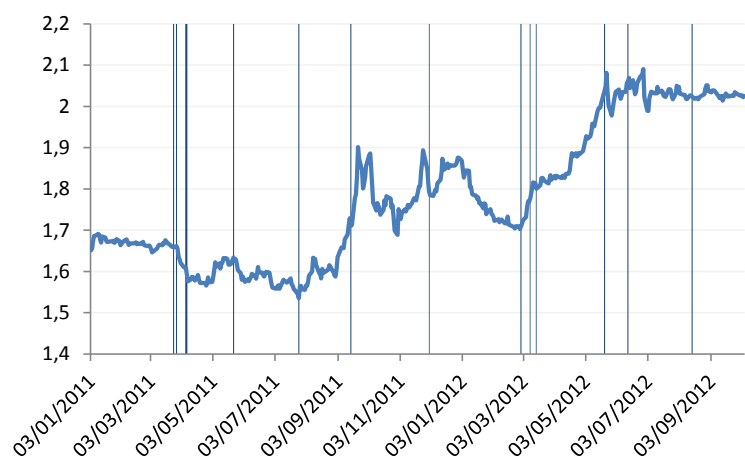
Source: BCB. Bars indicate changes on financial transactions tax.

Figure 13: Liquid position on financial exchange contracts (US$
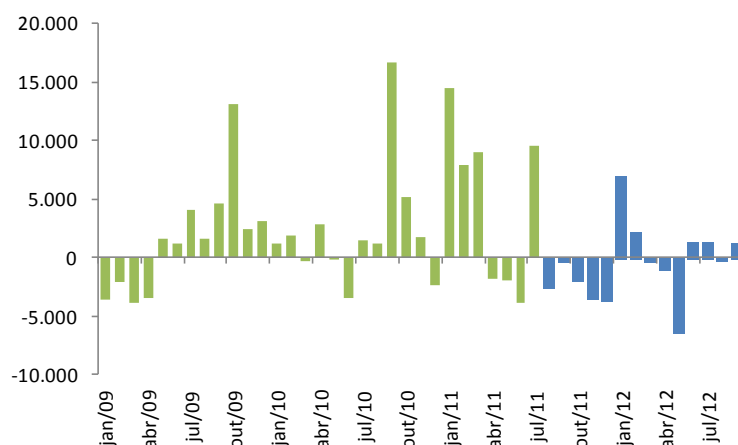
Source: BCB.

There are two divergent diagnoses regarding Brazilian industry bad performance in the recent years. According to the first one, a deindustrialization process has been in course, a Brazilian version of the 'Dutch disease' (Bresser-Pereira, 2010). The other one stresses the premature specialization of Brazilian industry, due to the poor macroeconomic performance and to the appreciation of the real (Carvalho and Kupfer, 2011). Nevertheless, the supporters of both agree that an R$ 2.00/US$ exchange rate – rather than an R$ 1.60/US$ - contributes to improve the competitiveness of Brazilian enterprises internationally.

Capital controls were brought again to the center of the agenda. The actual Brazilian finance minister, Guido Mantega, publicly stated that Brazil is prone to use capital controls and intensify the existing controls if necessary. This statement was made after the Federal Reserve announced the third round of quantitative easing, showing that new measures could be taken to make up for the effects of the FED monetary expansionist policies, establishing what he called the currency war.

4. The Economic Policy Recent Change: *gattopardo* change and no new development convention

The ample set of measures timidly started being put into force under Lula since 2007, especially the ones edited by President Dilma's, may suggest that the previous orthodox economic policy – prioritizing inflation control using the interest rate as its basic tool – has given place to a "new", more flexible policy, enriched by the diversification of means and goals.

Judging from the number and the diversity of economic areas the shifts were addressed to, it is reasonable supposing this impression sounds rather correct. After all, changes spread throughout all spectra of EP, i.e. fiscal, financial, of exchange rate and foreign capital control, and even in the monetary policy, the corn stone of the current EP. The main differences between the macroeconomic frameworks of 1999-2006 and 2007-2013 are illustrated by the schemes below.

In one hand, inflation control count on wider set of instruments, such as macro-prudential tools, tax exemptions (in energy and food), used in addition to the monetary policy. On the other hand, fiscal policy started being used to somehow sustain demand. Even monetary policy seemed to have been changed in a way: the interest rate has been kept in more reasonable levels helping sustaining demand, signaling it was not focusing price stability at any cost.

Financial stability has also become an explicit objective, to be accomplished by means of macro-prudential tools. The system of loans (short or long-term) was shifted increasing the share of public and development banks aiming stressing competition in order to reduce spreads; and some other measures were adopted to foster long-term capital markets.

Lastly, the exchange rate policy started counting on capital controlling measures in the face of massive entrance of short term foreign capital appreciating the real by taxing nonresident portfolio equity and debt inflows.

Scheme 1: Monetary Policy Framework in Brazil between 1999 and 2006
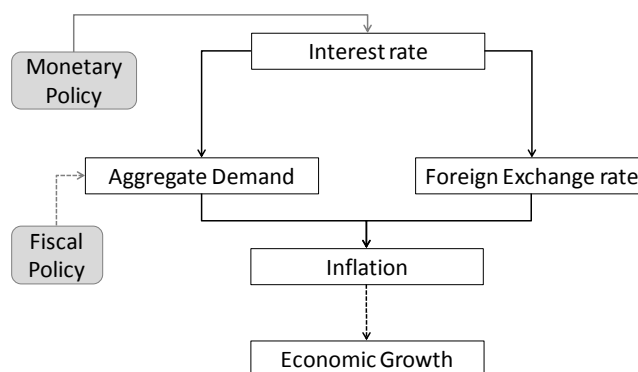
Source: Authors'elaboration.

Scheme 2: Monetary Policy Framework in Brazil between 2007 and 2013
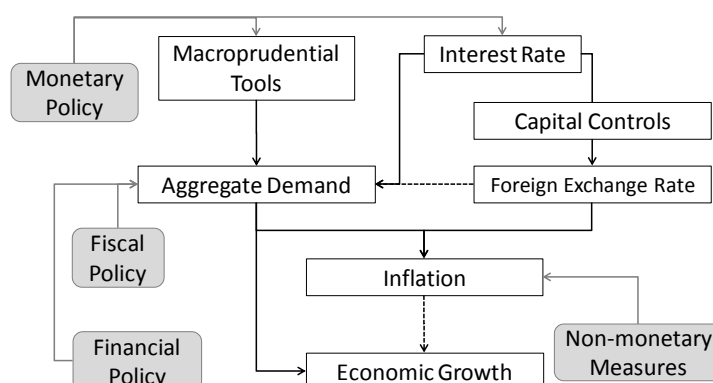
Source: Authors'elaboration.

Can one properly affirm that, eventually, a new economic policy (EP) regime was introduced in Brazil? And so did the EP change provide the basis for the building up of a new development convention?

To accurately answer the first question it would be helpful to recourse to the concept of *gattopardo change*: "gattopardo constitutes change that keeps things the same" (Palley, 2013:1). The concept was proposed by Palley, who named it after the Luchino Visconti's *Il Gattopardo* (The Leopard), a film based on the novel by Giuseppe di Lampedusa about the revolutionary rising of the bourgeoisie in Sicily.in the

1860s. In the story, an aristocrat character concludes that "things must change if they are to remain the same". And the movie shows that "after the revolution, the old aristocracy remains in charge, allied via marriage with the new urban elite." (Palley, 2013: ibid). The same happens with economists that, given the failure of the orthodox theory, suggest perfunctory changes in its framework.

Palley's concept fits as a glove to qualify the change in the Brazilian EP.

The answer to the first above question is definitely – and unfortunately, in our view – no. The hard core of the actual EP remains the very same: inflation targeting; floating exchange rate; and primary budget surplus targeting. Essentially, inflation controlling remains its prime goal, and interest rate is the mean to achieve it. As a matter of fact, the measures taken in second Lula's term and under Dilma was cosmetic preserving EP's essence. It was in two words gattopardo change.

And now, what about the second above question: a new DC?

As Erber proposed, "a **development convention** is concerned with structural change. This begs the question about which 'structures' are to be changed? The answer to that question differentiates development conventions".

So, it is really troublesome arguing that the recent change in Brazilian EP, meaning gattopardo change, can be taken as the basis for constituting a very *agenda* – in the sense in which it is used in Erber's conceptualization of DC – as required for the social-political process of formation of any hegemonic DC. In short: the stability convention still remains ruling in Brazil.

5. Final Remarks

Two development conventions have been disputing hegemony in Brazil: a *pro-growth – state led* and a *pro-stability – free market* conventions. From the WW II till the end of the 1970, the first was dominant. With the surge of liberalism worldwide and the final exit of inflation control from the mid 1990's on with the Real Plan, the stability convention conquer hegemony that was reinforced by the adoption in 1999 of an EP focused in inflation targeting.

This policy resulted in low growth; high interest rates; relatively high inflation; and overvalued currency, but until the 2008 global financial crisis, the stability convention had unquestionably been hegemonic.

In the second Lula's term, most properly under Dilma, there have been some non-orthodox measures. Surely, some of them were taken with the concern to keep demand level and so the growing of GDP. However, the fiscal policy was not made a permanent countercyclical instrument. Thus, the change did not mean an inflexion in the EP towards a Keynesian one, as proposed by some.

More broadly speaking, those shifts were too perfunctory to constitute a genuine change in the EP. In fact, the economic tripod policy was left entirely preserved, remaining inflation control as its permanent goal and the interest rate as the instrument to achieve it. So, the change did not really change the EP. It was true gattopardo change.

Nevertheless, this does not mean that it had no consequence at all. On one hand, it helped to somehow turn more bearable some of EP's bad effects. On the other, it tends to contribute masking the very orthodox nature of the EP.

It is not reasonable arguing that the recent change in Brazilian EP, meaning gattopardo change, can fulfil the necessary conditions to constitute a DC whether it does not provide even a real agenda. Without it, it is senseless speculating about teleology, social-political supporting etc.

Besides that, the rising of a new hegemonic DC is now highly unlike for the stability convention's power is outstandingly as strong as ever. Evidence which those who expect the enthroning of a new one should recognize

In sum: for very ponderable reasons it is not wise proposing the complex social process of forming a hegemonic DC is to be surge in the foreseeing future.

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