THE 1964/66 ACTION PROGRAM OF BRAZILIAN GOVERNMENT

by Benjamin Higgins

On August 13th, 1964 the Brazilian Ministry of Planning presented to Parliament an Action Program for 1964/66. This Program was the result of a few weeks of concentrated round the clock effort by a small team associated with the Ministry of Planning. Some members of the team were recruited for the purpose on an ad hoc basis; others were technicians working on various sectors of the economy in other Ministries; a few were directly attached to the tiny Secretariat of the Ministry of Planning itself. The document is some 500 pages long. Over 300 pages relate to individual sectors: power, transport, agriculture, industry, education, housing, natural resources, and regional development, and the rest relate to general economic policies.

The Action Program is not an "implementation program", in the sense of integrated and firm budgets covering all public projects to be undertaken during the period, together with detailed legislation to encourage and guide private investment; nor is it a long run "perspective plan" setting forth the broad lines of development for the economy as a whole over the next decade or two. It combines some aspects of perspective planning and some features of implementation programming. Essentially, however, it is an analysis of Brazilian economic problems, a statement of policy objectives, and an indication of the policy measures to be undertaken to attain those objectives. It reflects the basic objectives laid down by the current administration — stabilization, development and reform. It is perhaps less detailed, in terms of specific projects, than some earlier Brazilian plans. It is recognized by the government to be only the first of a series of steps needed to crystallize stabilization policies, economic and social reform measures, and long-run development programs. On the other hand, it is probably the most complete analysis of economic problems and policies ever presented by any Brazilian government.

The basic analytical framework is fairly simple and straightforward (see Appendix): inflation in Brazil has recently reached proportions which not only bring balance of payment disequilibrium, but which endanger continuous economic growth. Whatever may have been the arguments in the past regarding the effect of inflation on economic growth, it is now apparent that inflation must be checked as soon as possible, if healthy economic development is to be resumed. At the same time the government does not wish to retard growth unnecessarily nor to create mass unemployment during the transition period. Nor does it want to postpone indefinitely badly needed reforms in the fields of taxation, education, land tenure, and civil service administration.

The present administration also wishes to check the process of "socialization by default" — that is, the gradual increase of the share of government in total investment.
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resulting from inadequate investment incentives in the private sector. Accordingly, the government does not want to restrain the flow of credit to the private sector in a degree that would prevent private investment from keeping pace with the necessary minimum expansion of public investment. Certain minimum levels of investment (public and private) are needed to restore a satisfactory rate of increase in per capita income and to avoid increasing unemployment and underemployment. The state of the Brazilian economic organization is such that some investment in social overhead — especially transport, power, housing and education — is necessary for continuing growth. Responsibility in this field has come to be assigned mainly to the public sector. When all effort have been made to reduce current government expenses and transfer payments, there will remain a hard core of essential public outlays which are needed for economic growth itself.

Tax reform is regarded as a major instrument of government policy, but there are political, administrative and economic limits to the rate at which tax revenues can be increased. Given the past records of chronic inflation, there are also limits to voluntary private savings until confidence in the cruzeiro can be restored.

In the light of all these considerations, it is clear that there remains an unavoidable gap between minimum investment requirements and potential voluntary savings plus tax payments, which will have to be met by monetary expansion. Not much relief can be counted upon from the external sector. For the year of 1964 as a whole the increase in means of payment will, unfortunately, be the largest on record. Much of this monetary expansion took place before the present government was in control of the economy. The third quarter always brings a seasonal expansion of credit needed to move the coffee crop. Starting with the fourth quarter of 1964, however, the rate of monetary expansion will be checked. In 1965 it will be well below 1964, even in absolute terms. In 1966 monetary expansion will be brought under complete control and price rises reduced to insignificant proportions.

Objectives of the Program

The Program sets forth five fundamental objectives of economic policy:

1. to accelerate the rate of economic growth, interrupted in 1962/63;

2. to gradually curb the process of inflation during 1964/65, so as to obtain reasonable equilibrium of prices at the beginning of 1966;

3. to assure through investment policy adequate conditions for productive employment to absorb the continuously expanding labour force;

4. to alleviate regional and sectoral inequities, and tensions created by social imbalances, through improvement of social conditions;
(5) to correct the tendency toward deficits in the balance of payment which menaces the continuity of the process of economic development through strangulation of the capacity to import.

It will be noticed that the list of objectives include no specific statement regarding reduction of unemployment and underemployment. There seem to have been three main reasons for this omission: first, unemployment and underemployment, in the sense of people actively seeking work or more work as distinguished from low-productivity employments (sometimes misleadingly called "disguised unemployment") has not been a major problem of the Brazilian economy in the recent past. Secondly, it is felt rightly or wrongly — that resumption of a rate of economic growth equal to that of the 1950's would probably prevent increases in unemployment; thus the target of reducing unemployment might be considered to be subsumed under the target of restoring earlier rates of economic growth. Third, there are no satisfactory figures of unemployment and underemployment which would enable the Brazilian government to determine the extent of the problem at present time, or to measure the success of economic policies in eliminating unemployment and underemployment.

At the same time, limited studies undertaken by the Fundação Getúlio Vargas indicate that unemployment has increased substantially in some sectors of the Brazilian economy during the past year or two. Also, as is shown later in the Program itself, there is evidence that expansion of employment in the secondary sector — where increased employment is most important for economic development — has failed to keep pace with the rate of growth of the labour force, let alone the much higher rate of growth of the urban population. Labor-intensive industries have expanded less rapidly than capital-intensive ones, and even in the former category there has been a tendency towards substitution of capital for labor. In part these factors arise from a misguided wage policy, in part they are inevitable features of a process of industrialization and modernization. In considering investment requirements, therefore, it would seem desirable to make some allowance for absorption of existing unemployment and underemployment as well as for absorbing the increase in the labour force.

Instruments of Action

The Program isolates three main categories of policy instruments, financial policy, international economic policy and social productivity policy. Under financial policy is included: (a) reduction of budget deficits so as to reduce the inflationary pressure on the government, and to increase capacity for national savings, by regulating current expenditures and transfer payments, and by improving the composition of expenditures; (b) tax reform, designed to improve tax collections and enhance their anti-inflationary impact, to correct distortions in the incidence of taxation, to stimulate savings, to improve the orientations of private investment, and to reduce regional and sectoral inequalities; (c) monetary policy, designed to achieve gradual stabilization of prices, while avoiding a lower
of the level of productive activity and reduction of saving capacity of enterprises; (d) banking policy aimed at strengthening the credit system, adjusting it to the need to combat inflation and stimulate development; (f) public investment policy, designed to strengthen the economic and social infrastructure of the nation, to create the necessary external economies for development of private investment, and to reduce sectorial and regional inequalities.

International economic policies include three main subdivisions: (a) Foreign exchange and trade policies, designed to diversify sources of supply and to provide export incentives, so as to achieve long-run equilibrium in the balance of payments and to absorb in certain sectorial focal points of the economy excess productivity capacity. (b) Consolidation of foreign debt and restoration of the nation's credit standing abroad so as to relieve the short-term pressures on the balance of payments. (e) Encouraging the in-flow of foreign capital and active technological and financial cooperation of international agencies and other governments, particularly through the multilateral system of Alliance for Progress, so as to accelerate the rate of economic growth by strengthening our capacity to invest and import, and through absorption of technology.

Under social productivity are included four major branches of policy. (a) First, and most fundamental, is a wage policy designed to assure participation of workers in economic development, to protect labour's share of national income against inflation, and to permit the synchronization of the demand and cost side of the fight against inflation, and protections of the capacity to save. (b) An agrarian policy, to raise production, productivity, and to elevate the condition of the men in the field, and to improve conditions of employment in the rural sector. (c) A housing policy designed to facilitate home ownership for the less privileged classes, and to stimulate the absorption of unskilled manpower in civil construction activities. (d) An education policy, aiming at expanding education opportunities, rationalizing the allocation of available resources, and adjusting the pattern of education to the technical requirements of modern society.

Planning Brazilian Style

The concept of planning of the present Brazilian administration is closer to that of USA, Canada or France than it is to that of Norway, the Netherlands, or Sweden, and bears little resemblance to the global "balance planning" of Soviet Bloc countries. It means simply intervention in the market through monetary, fiscal, foreign trade and exchange, and similar aggregative policy instruments, in order to achieve the stated objectives. It is described by the Government itself as "a program for the co-ordinated action of the government in the economic field."

The Program explicitly states that it is not part of the objective of present government to annul the regulatory role of the price system. It recognizes that free market forces do not guarantee a desirable level of savings and investment, do not
always provide sufficient incentives for the formation of external economies (education, roads, etc.), do not necessarily provide a satisfactory distribution of national income among persons and regions; it also recognizes that the price system can be distorted by spontaneous and institutional imperfections in the market. However, government action is regarded as complementing and strengthening rather than replacing the market mechanism. In American terms, the political and ideological position of the Brazilian government's Action Program might be likened to the New Deal or the Fair Deal, although in its analytical approach it may be somewhat closer to the "indicative planning" adopted by France during the past decade.

In the Government's view the essential components of a development plan are: (a) a list of investments to be directly undertaken by the Federal Government and the sources of funds to be used for their financing; (b) a list of the production and investment goals to be attained by the "autarchies" (autonomous government agencies) and enterprises controlled by the Federal Government and their relation to available resources; (c) a list of private investments to be directly supported by Federal Government; (d) the budget and cash expenditures program of the Federal Government; (e) the program of operations of the monetary authorities; and (f) instruments of indirect action in the private sector, comprising economic legislation in general, including tax, credit, foreign exchange policies, etc.

**Investment Requirements**

Total investment requirements for 1964/66 are calculated on two bases: employment targets and income targets. These estimates are admittedly only rough guidelines, because of the general inadequacy of the relevant statistics. Due to the failure to finish the analysis of 1960 census data, even the demographic information is incomplete.

The Program assumes that the high overall rate of population growth — in excess of 3% per year — can not be reduced by any governmental action in the period covered by the Program. Accordingly the growth of the labour force is estimated at 1.1 million workers per year. The incremental capital/job ratio (increase in the stock capital needed to create one new permanent job) is estimated at 1,800 dollars in the urban sector and 700 dollars in the rural sector. With the present division of the labour force between rural and urban sectors, an average investment of 1,200 dollars would be needed for each additional worker. Absorbing the increase in the labour force would then require investment of 1.3 billion dollars per year. Converting dollars into cruzeiros, at the current official rate of 1,200 cruzeiros to the dollar, investment requirements on this basis would amount to 18 trillion, or 3.7% of gross domestic product. Adding the estimated annual depreciation, amounting to 5% of gross domestic product, brings required gross investment up to 13.7% of G.D.P.
It is recognized by the authors of the plan, although not clearly stated in the present preliminary draft, that this figure is low on several counts. First, the estimated incremental capital job ratios do not apply to the social overhead sector, where in fact they are likely to be much higher. Since a substantial proportion of new investment must be made in that sector, the effective average capital job ratio will certainly be higher than 1.20. Secondly, the assumption of unchanged occupational structure is untenable. The high rate of growth achieved in the decade of the 1950's was in considerable measure the result of transfers from agriculture to industry. Restoring high rates of growth will require continuous movement from the rural to the urban sector. Moreover, considerable numbers of people are already caught in the "pipeline" on route from agricultural districts to urban employment. Checking industrial investment at this point would aggravate the problem of open unemployment in the cities. Also migration to cities has been an escape valve for rural poverty and unrest that would be dangerous to close. Third, there has appeared during the last two years substantial open unemployment and underemployment in some industrial sectors and regions. Merely absorbing increases in the labour force is no longer an acceptable employment policy. Some effort must be made to absorb existing unemployment as well. Fourth, given the present level of technology and the structure of the Brazilian economy, raising productivity still requires some increase in the ratio of capital to labour. It is doubtful that the required improvement of Brazilian plant and equipment can be achieved through replacement, financed by depreciable allowances alone. If all these factors are taken into account it would appear that attaining the employment objective will require gross investment of at least 16% of the G.D.P.

The income target is stated as restoring over the next two years the yearly rate of increase in gross national income of 6%, and then raising it to 7%. Given the estimated growth of population, this figure would mean growth of per capita income of 2.4% and 3.3% respectively. In other words, the aim is to double per capita income in one generation.

The Program frankly admits the present inability of the government to determine precisely the appropriate incremental capital output ratio. On the basis of an assumed ratio of 2:1 gross investment required to achieve income targets would be 17% of gross national income. If the ratio is estimated at 2.5:1 the gross investment requirement would be 20% of gross national income. Given the patterns of investment proposed, particularly the need for expanded investment in the infrastructure, it seems likely that the latter figure will come closer to reality than the former one. Thus the achievement of income and employment targets of the present government will require gross investment in the neighbourhood of 19% of gross national income.

The government rejects reduction of the share of labour in the national income as a means of raising savings and investments. Accordingly, in their view the administration is left with the following devices for that purpose: (a) Providing tax incentives for the reinvestment of profits and for the undertaking of personal economies, together with heavy taxation of superfluous consumption; (b) Strengthening private savings by
fighting inflation and creating negotiable instruments attractive to small and middle size economic units. (c) Implanting a policy of providing incentives to foreign capital, including foreign aid, so that total savings originating abroad may reach 20% of capital formation. (d) Introducing schemes for compulsory contributions from users of public utilities. (e) Raising tax revenues and reducing the percentage of current expenditures and transfer payments in gross national income. (f) Reducing deficits of the autarchies and mixed enterprises. (g) Pursuing a wage policy consistent with the anti-inflationary aims, which will restrain the private propensity to consume; (h) Eliminating foreign exchange subsidies to imported consumer goods.

Checking Inflation

The Program points out that Brazil has experienced secular inflation since the first days of independence. Prior to World War II, however, the problem of inflation did not assume alarming proportions. Cumulative and accelerating rates of increase in prices and of depreciation of the foreign exchange value of the cruzeiro really appeared only in 1959, when inflation gathered pace, and for the first time became truly out of hand. In the first quarter of 1964 the price rise reached the rate of 25%, which, had it continued throughout the year, would have brought aggregate price increases of 1414%. This situation is described by the present government as "the verge of hyperinflation which might become uncontrollable. In these circumstances", accordingly to the Program, "no other item is so urgent as the curbing of inflation."

The anti-inflationary policy has three main facts:
(a) The progressive reduction of the budget deficit. (b) Adaptation of wage policy to monetary policy, so that costs do not rise more than proportionally to demand. The objective is to keep the real wage at its average level of the last two years, raised in accordance with improvements in productivity. Thus labour's share of national income is to be maintained; inflation will not be translated into sacrifices of the less privileged groups. (c) Control of credit expansion.

Employment Policy

The nature of the employment problem has been indicated above. The hard core of government policy for improving employment opportunities is to encourage investment. In addition, several complementary measures are recommended: (a) Wage, foreign exchange and credit policies must be sufficiently realistic so as not to create distortion in the prices of factors of production which give an exaggerated incentive to substitution of capital for labour. (b) The civil construction industry must be stimulated by a housing program which makes home ownership accessible to the lower income groups and which provides new incentive for construction of rental units. (c) The supply of jobs in the rural sector should be improved by agrarian reform, designed to improve the utilization of land. (d) Incentives
should be provided to exporters, especially in labour-intensive industries, for better utilization of existing capital, and creation of new jobs through the elimination of excess capacity in key sectors, in the presence of foreign demand.

**Incomes Policy**

The chapter on distribution of income begins by pointing out that labour's share of national income in Brazil (34.9% in 1960) was higher than in the years 1947-1955, and high in comparison with most countries, particularly the ratio of wages and salaries to national domestic income in comparison with countries in a similar stage of development. In the list of 35 countries provided, only England, Switzerland, Sweden, Holland, Puerto Rico, Panama, United States and Canada showed higher ratios of wages to national income. However, the Brazilian figures refer only to the urban sector, and are not strictly comparable to the others.

The presentation contains a somewhat dubious suggestion of "justice" in the existing income distribution of Brazil. In fact, however, other factors than the relative levels of wages and of returns to land and capital affect the distribution of national income between wages and salaries on the one hand and dividends, profits, interest and rents on the other. One purely statistical factor is the way in which, and extent to which incomes of agricultural labourers and of self-employed agricultural proprietors are reported. If statistical coverage is complete in countries with large numbers of peasant proprietors, the share of wages in national income will be relatively low; yet the wage scale may be high relative to incomes of employers, in comparison with other countries. The proportion of the labour force engaged outside of agriculture, and also the degree of capital-intensity of the technology applied, also influence the share of labour in national income. What might be said, however, is that since modern sector of Brazil is a rather capital-intensive one, the share of wages in urban income would seem to be reasonably high. It is clear, however, that little can be said on this score until more work has been done on the statistics of production, employment and incomes.

The income policy stated in the Program, then, is that the share of wages in national income should be maintained at what is considered to be already a fairly high level. Given this basic principle, income distribution is to be improved by raising the ratio of tax revenues to income and by reducing the ratio of government expenditures to income, thus reducing the impact of "inflationary confiscation". Nominal profits must be restricted, but the real value of profits will be restored. Credit policy should be sufficiently realistic to permit adaptation to such increase in cost as still takes place, but sufficiently controlled to impede automatic aggravation of demand — pull inflation.

The chapter closes with a discussion of inequalities in the regional distribution of income. While some discrepancies in per capita output and income are regarded as natural in a
country as large and as geographically varied as Brazil, it is considered essential to reduce inequalities among regions below their current levels. For this purpose the government proposes: (a) To give top priority to public investment projects designed to create external economies in the most underdeveloped regions, particularly investment in surveys of natural resources and improvement of human resources. (b) To maintain the policy of preferential, fiscal and credit arrangements for private investment in the most retarded areas. (c) To activate the regional planning agencies, and to provide more administrative flexibility and continuity to their programs. (d) To allocate a relatively substantial proportion of foreign aid for investment and creation of external economies in the least favoured regions.

Financial Policy

Financial policy for 1964/66 is subordinated to the objectives of "introducing an inflection point" in the rate of expansion of the means of payment, in a manner compatible with the gradual achievement of reasonable price stability, without sacrificing economic growth, and without causing alarm. By the last quarter 1965 the monthly rate of monetary expansion should be consistent with a price rise of a little more than 10% per year. Given increased external aid, it is considered possible that the rate of monetary expansion and price increase, especially in 1965, will be even less than is here envisaged.

The principal factors affecting the rate of monetary expansion are the financial necessities of the federal government, the impact of the external sectors, and the cost-push, especially of wages, in the private sector.

Program for 1964

When the present government assumed power the 1964 budget was already in the process of execution. The projected deficits have already been substantially reduced through the elimination of foreign exchange subsidies, definite cuts in certain expenditures consistent with the economic plans, transfers of certain expenditures to 1965, and restraint of certain additional obligations. In addition, tax rates have been increased after approval of the budget through constitutional amendment. The government also hopes to obtain additional non-inflationary resources through voluntary subscriptions to Treasury obligations.

As a result, the cash deficit in real terms will be 20% below that of 1963. In 1965 cash outlays of 3.7 trillion are expected. Current expenditures and transfers will be reduced to the minimum consistent with operation of the government machinery.
In the external sector, it is expected that the net impact in 1964 will be only slightly inflationary. This effect results mainly from a substantial supply of foreign exchange available during the first semester and large repayments of foreign debts in the second semester, arising from earlier commitments at a time when the cruziero was overvalued. The Government also wishes to eliminate gradually the import deposit requirement.

For 1965 it is hoped that the external sector will be significantly anti-inflationary. However, the outcome depends on favourable conditions in the international coffee market, on the fact that foreign exchange obligations will be less than in 1964, on the availability of foreign resources, and on the degree of success obtained in implementation of the government's program.

**Private Sector**

Loans to the private sector during the third and fourth quarter of 1964 are estimated at $620 billion and $450 billion respectively. The total expansion of credit during the year as a whole will be 82%, which implies some increase in the volume of real credit. During 1965, however, total expansion of credit to the private sectors (excluding coffee) will be limited to $986 billion.

The net effect of the operation of all three sectors will be an increase in means of payment of $1,954 billion in 1964 and $1,417 billion in 1965. These figures may be compared with expansion of $741 billion during 1963 (from a base of $1,266 million) and $453 million in 1962 (from a base of $283 million). The projected expenses from monetary supply by quarters is shown in Table I.

(see next page)
Table I - Expansion of Means of Payment

1964-1966 (Cr$ billion)

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<th>II</th>
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<th>I</th>
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<tr>
<td>1964</td>
<td>245.3</td>
<td>352.5</td>
<td>700.4</td>
<td>656.5</td>
<td>272.5</td>
<td>318.1</td>
<td>470.5</td>
<td>356.0</td>
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The proposed reform of the tax system is regarded as having three main functions:

- to provide financial assistance to the government;
- to reduce social inequalities; and
- to improve the allocations as resources.

In the existing inflationary situation, the Government feels that priority should be given to taxes which encourage private savings.

The existing tax system is considered to have both fiscal and functional shortcomings. Evidence of fiscal deficiency is the budget deficit and consequent inflation and pressure. The functional defect is the lack of coordination of the tax system. The existing system is both incomplete and disconnected. For example, high tariffs on luxury goods are combined with low taxes on the same goods, with the result that resources are diverted to domestic production of non-essentials. Another functional defect is the lack of integration among federal, state, and local taxes.

Some of these defects have been alleviated by the recent tax reforms. For example, the scope of "pay as you earn" income taxation has been expanded. The next steps will include the following measures:

I - Income tax
   a) Extension of incidence;
   b) Simplification of several of its provisions;
   c) Reformulation of taxes on fiscal persons;
   d) Taxation of presumed income in agriculture, based on current value of properties.

II - Simplification of the stamp tax

III - Reform of the consumption tax
   a) To maximize impact on savings
   b) Restructuring of specific rates.

A new tax bill is in preparation and will be submitted to Congress in mid-September. The mean features of this bill are:

(Insert memorandum from Alex Kafka)

The government recognizes that the proposed tax legislation leaves an inadequate tax structure. Tax reforms, however, will require constitutional amendments and will therefore take some time.
APPENDIX (Mário Simonsen)

Investment Requirements

a) Requirements for Growth

Gross Investment requirements can be obviously calculated by the formula:

\[ s = vg + d \]

where:
- \( s \) = gross investment requirements as a proportion of G.D.P.
- \( v \) = net incremental capital:output ratio
- \( g \) = target rate of growth
- \( d \) = depreciation of fixed capital as a proportion of G.D.P.

For the period 19/7/1961, \( d \) has been estimated as being 5\%, \( g = 5.8\% \), \( s = 16.6\% \) (not including the cost of land which did not represent an actual investment). From these figures one may obtain an indirect estimate for \( v \) (\( v = 2.0 \)). Such a low ICOR has been possible because of the extensive nature of the increase of the agricultural sector; because import substitution has been mainly concentrated on low capital:output ratio industries, and because investment in housing has been neglected (as a consequence of the rent law and of the lack of mortgage programs, as a result of inflation).

It is impossible to present any serious forecast for the future ICOR. Two alternatives have been put into evidence. First, the maintenance of the past net ICOR = 2.0. Second, a larger ICOR = 2.5. The emphasis on the housing program and on infrastructure investments should act so as to increase the ICOR. However, the elimination of waste in public investments, and the removal of the sectorial focuses of idle capacity should act in the opposite direction.

According to the various hypotheses, the gross investment requirements would be the following:

<table>
<thead>
<tr>
<th>Gross Investment Requirements as a percentage of G.D.P.</th>
<th>net ICOR = 2.0</th>
<th>net ICOR = 2.5</th>
</tr>
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<tbody>
<tr>
<td>( g = 6% ) a year</td>
<td>17%</td>
<td>20.0%</td>
</tr>
<tr>
<td>( g = 7% ) a year</td>
<td>19%</td>
<td>22.5%</td>
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</table>
b) Requirements for Employment

At the present stage, the Brazilian active population is increasing by about 1.1 million persons per year (assuming an annual increase in total population of 3.5%). Taking into account the normal rural-urban emigration, such an annual increase would be divided into an additional supply of labor equal to 300 thousand persons in the urban and 800 thousand in the rural sector. The incremental capital: job ratio is very hard to estimate. A vague suggestion may be obtained by taking US$ 1,300 per job in the urban and US$ 700 in the rural sector. At current effective rates of foreign exchange (say $1.00 = T1.500) these figures include some allowance for investments which increase the productivity of workers already employed. Net investment requirements would thus amount to $1,650 million per year. Taking an exchange rate of T1.500 per US$ and a G.D.P. = 18,000 billion cruzeiros in 1965, net investment required for the absorption of the additional labour supply would amount to 13.7% of the G.D.P. Gross investment requirements would then amount to 18.7% of the G.D.P.

This percentage could be reduced if development is slowed down and rural-urban migrations interrupted. The latter, however, would bring considerable open unemployment in the cities.

Income Distribution

The structure of the income distribution should be analysed on the basis of the following equation:

\[ Y = W_g + W_p + R_p + L_r + L_i + T \]

where:
- \( Y \) = gross domestic output at current prices
- \( W_g \) = wages and salaries paid by the Government, at current prices after taxes, plus transfers
- \( W_p \) = wages and salaries paid by the private sector, at current prices, after taxes plus transfers from Government
- \( R_p \) = other personal incomes plus transfers from Government minus taxes
- \( L_r \) = retained profits of firms plus depreciation allowance minus \( L_i \), explained below
- \( L_i \) = illusory profits of firms, stemming from the replacement of inventories during inflation
- \( T \) = taxes minus subsidies, minus transfers.

We shall assume throughout our discussion that enough effective demand will be present to absorb all the productive capacity of the country. In an inflationary economy country like Brazil this is a normal assumption. Adequate policies, however, must be adapted so as to avoid sectorial insufficiencies of effective demand. Care will also be taken so as to avoid a more
rapid anti-inflationary policy from the demand point of view than from the cost angle.

Gross internal savings, except illusory profits stemming from inventory replacement should be given by:

\[ S = S_1 (Wg + Wp) + S_2 Rp + Lr + T - Cg \]

where \( Cg \) = consumption expenditures of government (which include \( Wg \) as a part of it)

We can assume a priori \( 0 < S_1 < S_2 < 1 \)

An important objective obviously consists in achieving a good \( S/Y \) coefficient. Short run policy will principally act on \( Wg/Y \), \( Wp/Y \), and \( T/Y \). Anti-inflationary measures should also reduce \( Li/Y \). Thus, under the hypothesis of sufficient aggregate demand, \( (Li + Rp)/Y \) will be determined as a residual. Such an hypothesis may appear as reasonable for a short-term analysis, if we look at \( Li + Rp \) as having the nature of quasirents.

The Programming of the Income Shares and of Inflation

a) Wage policy in the private sector will be conducted so as to keep constant \( Wp/Y \). Actually anti-inflationary policies could bring the risk of rising such a ratio. The government criterion for wage adjustments, however, avoids any further rise of such a ratio.

b) \( Wg \) has already been fixed (in nominal term) for 1964/65, as regards the Federal government. Its real value, however, is at present too large, and thus must be reduced through inflation. The same thing can be said with respect to \( Cg \). The inflation rate for the end of 1964 and 1965 has been derived so as to bring a sufficient percentage reduction of \( Cg/Y \). Such a reduction should be explicitly stated in the Program. Federal Public Servents will not receive any wage increase in 1965.

c) \( Ig/Y \) (\( Ig \) = public investment) should be kept approximately constant.

d) Once the inflation rate has been fixed, so as to reduce in a convenient way \( Cg/Y \), a certain monetary expansion will be needed, and quantitative assumptions will be accepted. Since the Expenditures of the Federal Government are given, the monetary budget will define the compatible value of the credit-expansion to the private sector minus taxes. We thus have one equation and two unknowns. (It is obviously a matter of indifference from the point of view of private expenditure, whether we reduce taxes or expand credit). In order to solve the indeterminacy, credit expansion will be calculated so that the real value of the loans to enterprises will increase in the
same proportion as the real product. In a quantitative approach, this would mean that credit to the private sector should expand in the same proportion as the total of means of payment.

The advantage of such a criterium derives from market imperfections. It is easier for a firm to get new funds from the banking system than through the issue of new shares. Of course profit reinvestment is still easier, but not always sufficient. It must be remarked that if we have inflation, firms need additional funds just in order to keep their volume of operation.

Given the amount of the credit expansion to the private sector, tax requirements can be determined as a residual of the monetary budget. This will require one increase of $T/Y$.

e) Summary of the Policies and Effects

Summarizing the above analysis, $Wp/Y$ will be kept constant by wage policy; $Wg/Y$ and $Cg/Y$ will be reduced by inflation; $Li/Y$ will be reduced by the reduction of the inflation rate; $RP/Y$ is expected to be lightly reduced by tax policy. As a consequence, $(Lr + T)/Y$ will rise. This will act so as to stimulate gross internal savings.

f) Foreign Capital

In order to reinforce gross investment, foreign capital is obviously desired. Qualitative measures have already been put into effect, so as to stimulate its inflow, such as the recent changes in the profit remittance law. The desirable current account deficit of the balance of payments can be easily calculated along the above lines, together with the necessary capital inflow, taking into account the programmed capital outflows (amortization of debt, etc.).