

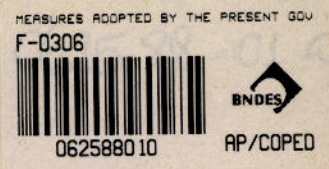
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NATIONAL BANK FOR ECONOMIC DEVELOPMENT - BNDE

BRAZIL

**MEASURES ADOPTED BY THE PRESENT GOVT. TO
COMBAT INFLATION AND ALLOW CONTINUITY
TO THE ECONOMIC DEVELOPMENT PROCESS**

RIO DE JANEIRO, MARCH 1965



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MEASURES ADOPTED BY THE PRESENT GOVERNMENT TO COMBAT
INFLATION AND ALLOW CONTINUITY TO THE ECONOMIC
DEVELOPMENT PROCESS

The government inaugurated in April made it one of its main objectives to combat inflation, that has ascended to unbearable levels for the last years. With a basis on the results of the first three months of 1964, it is possible to anticipate a rise of almost 150 per cent in the general price level.

The strategy adopted in fighting inflation was that of the so-called gradualist line instead of the traditional shock treatment often fatal to an organism that is already weakened.

Thus, many steps taken by the government were supplemented along the months that followed the Revolution to this day. The measures can only be well understood if taken altogether and with an anticipation of what is to be done in the next months. Of course the combat against inflation was started from the outset in several sectors at the same time, considering the interdependence of inflationary components. Thus wage, credit, exchange, tax and administrative policies were made to work together.

At the same time that it undertook to hold back the currency devaluation process, the government also sought to insure the conditions required for recovery of the economic development rate attained in the previous decade, without detriment to anti-inflationary measures. Thus, the present Administration's target has

been that of obtaining a quick reaction by the productive system through greater utilization of the existing capacity, acceleration of the capital building-up rate and increased efficiency of factors as associated with the technological change.

The Executive's action progressed rather smoothly thanks to the powers conferred by the Institutional Act of April 9, 1964, which instituted a new political order in the country.

Article 3 of the Act gave the President permission to submit proposals of amendments to the Constitution to the National Congress, to be voted upon within a maximum period of 30 days. The Act provided that approval of these bills would only require a simple majority of votes, instead of the 2/3 established in the Constitution.

The Institutional Act also granted the President the power to submit to Congress bills on any matter, which are to be decided upon within 60 days or 30 days should the matter be considered to be of an urgent nature (Art. 4).

Bills creating or increasing public expenditure were made of the exclusive initiative of the Head of the Executive, the two Houses of Congress being forbidden from presenting amendments to increase the proposed expenditure.

The principal steps taken by the Federal Government, in its policy against inflation and in favor of economic development, will now be examined according with the following scheme:

Policy for the reduction of the governmental deficit and
Tax Reform

Wages Policy

Reactivation of economic development

- Incentives to savings
- Speeding up of the investment rate and utilization of idle capacity

Export policy

Economic and Social Reforms

- Foreign capital
- Banking reform
- Housing reform
- Land reform

POLICY FOR THE REDUCTION OF THE GOVERNMENTAL DEFICIT
AND TAX REFORM

Although the budget for 1964 has been approved with an estimated expenditure of Cr\$ 2.110 billion and an estimated revenue of Cr\$ 1.479 billion, with a declared deficit of Cr\$ 631 billion, these amounts were known not to correspond to reality. Corrections made, plus the addition of the increase in wages of civil and military personnel, carried the potential total amount of Expenditure up to Cr\$ 4.2 trillion. As Receipts were to remain the same, the Treasury's deficit in 1964 would really be of the order of Cr\$ 2.5 trillion.

In order to cut down that deficit, considered by present governmental authorities as one of the most dangerous sources of

inflation, the following measures have been taken:

ON THE EXPENDITURE SIDE

- a) Bills creating or increasing public expenditure were made to be of the exclusive initiative of the President and neither of the two Houses of Congress can offer amendments tending to increase the expenditure proposed by the President (Institutional Act).
- b) Subsidies to wheat, newsprint and petroleum by-products consumption were eliminated, the import of these products being made now at the exchange rates applicable to other essential imports (Currency and Credit Authorities - SUMOC - Instruction nº 270).
- c) Reduction of the deficit of autonomous governmental agencies (railways, merchant marine, etc), through a readjustment of rates, reduction of defraying expenditure, improvement of operational efficiency, elimination of uneconomic railway branchlines, etc.
- d) Emergency program for the reduction of governmental expenses in the fiscal year 1964, taking as a basis 30% of the variable expenditure foreseen in the prevailing budget (Decree Nº 53,949);
- e) Wages policy: 1. Correction of the differences in wage levels between servants of the centralized federal administration and of autonomous government agencies (autarchies) (Law Nº 4,345), 2. Reduction in the higher wages of civil and military personnel (bill), and
- f) Budgetary restraint of up to 30% on the Expenditure of the Executive Power in 1965 (Law Nº 4,539).

ON THE REVENUE SIDE

- a) Constitutional amendment to permit collection of taxes not previously authorized in the Budget in the fiscal year 1964 (Constitutional amendment nº 7). With a basis on this authorization the Government started the tax reform by modifying the income tax legislation with the expansion of the withholding tax area (Law Nº 4,357), the excise tax legislation (Law Nº 4,388);

- b) Cutting off of general tax exemption as regards the earnings of magistrates, copyrights, the remuneration of teachers and newspapermen (Constitutional amendment N° 9 and Law 4,480);
- c) Reform, effective as from 1965, of the excise tax (Law 4,502), stamp tax (Law N° 4,505) and Income tax (Law N° 4,506) legislations, for the purpose of reinforcing receipts and simplifying and systematizing tax procedures, with a view to creating facilities for taxpayers and permitting a better operation of the collecting mechanism, and
- d) Reappraisal of the fixed assets of domestic companies, with payment of 5% of the reappraised value (Law N° 4,506).

OTHER MEASURES

- a) establishment of a monetary correction clause for fiscal debts, in order to eliminate incentive to late payment of taxes as represented by the inflationary process (Law N° 4,357);
- b) Organic Law for the Fiscal Process and reorganization of the present Taxpayers' Councils (bill);
- c) Reorganization of the present Customs Revenue Department and establishment, on a nationwide basis, of the service for the prevention and repression of contraband (bill), and
- d) Combat against tax evasion by expanding its concept and utilizing external signs to impugn income tax returns and determine the income of taxpayers (bill).

Wages Policy

The anti-inflationary policy presupposes a healthy wages policy. In this particular, the government's economic policy is represented by the following measures:

- a) reorganization of the National Wages Policy Council and formation of its technical staff at a level compatible with the execution of its tasks (Decree № 54,228);
- b) establishment of rules regarding the levelling of the wages of autonomous agencies and centralized administration personnel, including a revision of the wage situation of the said personnel (Law № 4,345);
- c) any wage readjustment of a collective nature in the federal public service area or in that of private companies subsidized by the Federal Government or operating public services can only take place after the National Wages Policy Council is heard (Circular № 10. of 6.19.1964, of the Presidency of the Republic).
- d) establishment of a minimum period of one year for revision of wages controlled by the Federal Government and similar recommendation to Labor Courts in the judgement of collective bargaining cases (Circular mentioned above), and
- e) decrease in the higher wages of civil and military personnel and directors and employees of private companies (bill).

Reactivation of the Economic Development Process

The task of revitalizing the national economy, seriously threatened in its development by an impending

hyperinflation, requires careful strategy and immediate action, which is to be mainly concentrated on the efforts towards the building up of capital.

INCENTIVE TO SAVING

The objective of increasing the saving rate should be reached not only through an appeal addressed directly to the different sources of savings - families, corporations, Government and foreign sources - but also through an improvement of the capital market.

Let us consider what has been done by the present Government with regard to the different sources:

- a) the following instruments, already adopted, may be pointed out as incentives to personal saving: income and excise taxes reform (partial or total exemption from taxes concerning income applied in certain bonds; more intensive taxation regarding utilization of luxury items), compulsory capitalization policy by users of public services (Law n° 4,364), and creation of new methods for savings investment (Treasury bonds, real estate bonds, created by the Laws n°s 4,357 and 4,380);
- b) encouraging companies to save through fiscal stimulus for reinvestment or through the creation of funds such as the Labor Compensation Fund (Law n° 3,457)
- c) boosting Government savings through reduction of current Government expenditures and increase of Government Receipts
- d) promoting an influx of foreign savings through a reformulation of foreign capital policies (Law n° 4,390)

The speeding up of the capital formation rate may be achieved through a new structure of the capital market which, in addition to being in the initial stage of development, has very serious deficiencies in its organization. The steps listed below aim at strengthening and activating this market:

- a) permission to deduce from the net income of individual tax-payers for the purpose of income tax payments, compensated by the acquisition of Treasury Bonds, real estate bonds or shares of corporations of greater interest to the national economy (Law n° 4,357)
- b) a better control over Private financing institutions, Banks and Credit, Financing and Investment Organizations (Law n° 4,595)
- c) control over capital markets in general and restrictions regarding the access of foreign corporations to the national financial market (Legislative Bill);

National savings are, moreover, reinforced by

- a) the creation of a sole tax on minerals and establishment of a National Mining Fund (Law n° 4,425);
- b) the approval of the educational salary (Law n° 4,440) and
- c) the increase in the revenue from the sole tax on liquid and gas fuels through a change in the structure of that tax. (Law n° 4,452).

SPEEDING UP OF THE INVESTMENT RATE AND UTILIZATION OF IDLE CAPACITY

In addition to fighting inflation, the present Government has been concentrating its efforts on getting a prompt

reaction from the productive system, through a better utilization of the existing capacity, the speeding up of capital formation rate and the increased efficiency of factors related to the technological change. The steps taken to that effect are listed below:

Agricultural Sector

- a) Land Reform (Law nº 4,504)
- b) establishment of minimum prices to encourage the agricultural producer and utilization of the whole private and official system for the purpose of implementing the above step (Decree nº 54,294)
- c) organization of the rural credit through the creation of the National Coordination of rural Credit now making use of the National Fund for Rural Refinancing (Decree nº 54,019)
- d) release of compulsory deposits from Commercial Banks to be utilized in agricultural financing operations (SUMOC Instruction nº 273),
- e) importation of fertilizers financed at long term through an Agreement with AID, the countervalue in Cruzeiros being intended to the Refinancing Fund.

Industrial Sector

- a) immediate encouragement to investments by permitting the depreciation of new equipment to be accelerated until 1968, in the sectors producing manufactured export goods, in those directly affecting the cost of living and which enable a proper utilization of the idle capacity in industry or require modernization.
- b) establishment of a Fund for the Democratization of Companies' Capital - FUNDECE - intended to provide operating capital resources to such industrial enterprises in the country as undertake to raise their production and productivity indices and accept formulas involving the opening of their capital (Decree Nº 54,105);

- c) establishment of a Financing Fund for the Purchase of Industrial Machinery and Equipment - FINAME. This Fund, represented by a graphic account in the books and papers of the BNDE, will be designed to finance operations for the purchase and sale of machinery and equipment of domestic make, through the extension of credit either to purchaser or to seller. It will also, whenever possible, grant financings to projects for the establishment of new small-size industries and expansion of existing ones, according to the criteria and limits set forth in the Fund regulations (Decree Nº 55,275);
- d) granting of a reduction of up to 50% of the value of the import tax as regards equipment for the chemical industry, with exemption from payment of surtax or compulsory deposit in the purchase of foreign currency to cover the import of such equipment or raw material as is held essential by the Executive Group of the Chemical Industry (Decree Nº 55,759);
- e) establishment of a Financing Fund for the Preparation of Projects - FINEP - with resources from loans and donations by domestic and foreign organizations, for the purpose of extending financings for the drawing up of economic development projects and programs (Draft bill);
- f) establishment of a Mining Fund intended to encourage mineral prospection, as well as studies and researches connected with mineral production activities (Law Nº 4,425);
- g) development of the highway program with resources from the assessment of taxes on liquid fuels, which were until recently insufficient to cover expenses with that program (Law Nº 4,452);
- h) establishment of an Industrial and Agricultural Reconversion Fund intended to finance projects submitted by rural landowners whose properties are expropriated against payment in the form of Agrarian Debt Bonds (Law Nº 4,504);
- i) supplementation of the BNDE's resources by channeling to the Bank 20% of the Income Tax collection (Law Nº 4,506);

- j) expansion of the duties of the National Research Council (Law Nº 4,533);
- k) normalization of customs exemption with the purpose of encouraging the government's investment policy (bill);
- l) creation of new incentives (tax an financial) to companies that increase their productivity (bill);
- m) establishment of a deposit of 30% of the value of exchange operations resulting from the export of beef, with the purpose of financing economic activities connected with the production, industrialization and marketing of beef and specially the stock-piling of the product to meet internal consumption requirements (Currency and Credit Authorities - Instruction Nº 290)
- n) authorization for the CACEX to licence, with exemption from the Undertaking to Licence, the import of used machinery not having domestic similar provided it is intended for use by the importing company itself. (Currency and Credit Authorities - Instruction Nº 276)

Export Policy

The Government has sought to foster the expansion of exports and their diversification through the following measures:

- a) creation of a Committee for Foreign Trade aimed at promoting and guiding the domestic trade interchange, in line with the country's economic development policy (Decree no. 53,898);
- b) simplification of the draw back system, in the case of imported raw materials and materials used in the production of exported goods (Decree no. 53,967);
- c) establishment of preferential conditions, by PETROBRÁS, regarding bids for the purchase of petroleum and its by-products, in such way that these conditions, without detriment to competitive prices, may forecast and allow the resulting export of Brazilian products (Decree no. 53,892);
- d) increase in the mining and export of iron ore, thus allowing the construction of private shipping terminals by companies that intend to export a volume of freight higher than the actual availability of the port of Rio de Janeiro or to use ships with a draught exceeding the operational facilities of this port (Decree no. 55,282);
- e) export refinancing through the Exchange and the Foreign Departments of the Bank of Brazil (SUMOC Instruction no. 278);
- f) establishment of special exchange quotas exempted from compulsory deposit, so that companies that make exports can use such quotas for the payment of imports and financial commitments (SUMOC Instruction no. 279);
- g) institution of the form of export under consignment (SUMOC Instruction no. 284);
- h) simplification of red tape and creation of an "Exporter's Counter" under the Foreign Trade Department of the Bank of Brazil, aiming at assisting exporting companies with regard to administrative processing;

- i) remuneratory exchange rates, in order that Brazil's competitive power can be maintained in international markets; and
- j) institution of a credit export insurance system against political and commercial hazards. (Bill).

Economic and Social Reforms

- Foreign Capital

The collaboration of foreign capital should not give rise to an inferiority status for the domestic entrepreneur, who will be given adequate supporting measures and particularly financing by official institutions.

The foreign capital policy, as contemplated in the Action Program of the present government, has considered external financial resources as a means to speed up the country's economic development.

Law no. 4,390, of October 29, 1964 eliminated from Law no. 4131 on foreign capital its negative aspects and established the equivalence between the original capital and reinvestment, eliminated the systematic limitation on remittances set forth by articles 31, 32 and 33 of the former Law and, in addition, simplified bureaucratic requirements for registration. (Law no. 4,390).

Additional information on this matter

By Law no. 4,131, of September 1962, no company could make remittances abroad, as profits, of over 10 per cent of

the registered capital. Reinvestment was not considered as foreign capital and this fostered its flight from Brazil. The new Law, in addition to admitting of the qualification of foreign capital for reinvestment of profits arising out of the said capital, eliminated the limitation for profit remittances, save in respect of profits originating from productive activities of goods and services of luxury consumption, in which case the ceiling is of 8 per cent of the registered capital.

Profit remittances that exceed this limit shall be considered as principal repayment and they shall be deducted from the corresponding registration for the purpose of future remittances. Their reinvestment, however, is allowed in activities considered of interest to the domestic economy.

While by the former Law profits and dividends assigned to resident physical or juridical persons or with headquarters abroad were subject to the withholding tax at the rates then prevailing for dividends due to bearer's shares, by the new Law only the amount actually remitted abroad is subject to the supplementary income tax and whenever the average remittances, in a three-year period, are in an excess of 12 per cent over registered capital and reinvestments, in accordance with the following schedule: Between 12 and 15 per cent of profits, 40 per cent; between 15 and 25 per cent, 50 per cent; over 25 per cent, 60 per cent.

According to the two laws referred to above, restrictions, for a limited period only, are also imposed on imports and remittances abroad of returns on foreign capital whenever a

serious imbalance on the balance of payments occurs or is about to occur. In this case, no remittances shall be allowed as principal repayment, and profit remittances will be limited to a maximum of 10 per cent (under ordinary conditions without any limitations) a year on capital and reinvestments, said percentage being lowered to 5 per cent (under normal conditions, 8 per cent) in the case of profits deriving from the production of goods and services of luxury consumption. The most striking difference in the texts of the former and the new Law is that, while in the former the maximum percentage is only on the original capital, in the latter the same percentage is computed on the original capital plus reinvestment.

Articles 31, 32 and 33 of Law no. 4,131, superseded by Law no. 4,390, of October 29, 1964, were worded as follows:

Art. 31 - Yearly profit remittances abroad may not exceed 10 per cent of the value of registered investments.

Art. 32 - Profit remittances which exceed the limit established in the previous article shall be considered as principal repayment and shall be deducted from the corresponding registration for the purpose of future profit remittances abroad.

Sole Paragraph - The annual repayment of foreign capital shall not exceed 20 per cent of the registered capital.

Art. 33 - Profits which shall exceed the limits established in article 31 of this Law shall be registered separately as supplementary capital and shall not be eligible for future remittances.

- Banking reform -

The banking reform, for a long time the object of discussions in Congress, was finally turned into law late last year. Brazil was one of the few countries in the world with a Central Bank of a mixed type - the Bank of Brazil that was simultaneously Government's bank, banks' bank and Central Bank. Currency authorities were entirely under control of the Executive Power, turning the monetary policy into a non-autonomous branch of the fiscal policy.

According to the Banking Reform Law, the BNDE is the main agent for the execution of the Federal Government's investment policy pursuant to Laws Nos. 1628/52 and 2973/56.

The SUMOC - Currency and Credit Authorities - is changed into a Central Bank, acting as Issuing Bank and Monetary Policy Controller. The Monetary Council is established, with half their members appointed for a fixed term and consequently free from any political injunctions. Likewise, Private Financing Institutions, Banks and Credit, Financing and Investment Companies are made subject to a more suitable control (Law No. 4,595).

- Housing Reform -

With the purpose of bringing under one sole policy the real estate activities now in the hands of uncoordinated federal and local agencies, a Financial System has been established, with its own administrative structure. It is founded on the

possibility of monetary correction in real estate contracts, restricted to such operations as fall within the purposes of the project.

The regulation, control and coordination of this new financial structure are entrusted to a new entity: the National Housing Bank. Its capital will be made up by the contribution of 1% of the payrolls of companies (Law No. 4,380).

At the same time the Government reformulated the Tenancy Law so as to restore private interest in the purchase of houses for letting purposes. The solution adopted by the Government was once more that of bringing the market to price reality. The new rentals will be subject to monetary correction whenever the minimum salary is readjusted. Old rentals will be progressively brought up to date by means of a formula of smooth transition for the tenant. Such a formula will, however, promote a final adjustment to reality at the end of a period of ten years (Law No. 4,494).

With the Real Estate Incorporation Law, the Government also set forth certain requirements to be met by Joint owners in housing construction and Real Estate Incorporations. The new law will stop the abuses that were frequent in the sector, rendering real estate investment safer for those who invest their savings in this area.

- Land Reform -

The Land Reform planned by the present Government is concerned with the good utilization of lands rather than with their

redistribution. Its main tool will be the Rural Territorial Tax which, in view of its progressive and differentiated incidence, will severely punish non-productive large land-holdings and reward well-utilized lands. As a complement use can also be made of the expropriation, now authorized, in areas of greater populational pressure and stronger social tensions, with payment in bonds with monetary correction clause (Law No. 4,504).

The Agency in charge, as proposed in the project, will be the Brazilian Land Reform Institute which will promote the carrying out of studies for dividing the country into homogeneous zones of districts from the social and economic standpoint, having characteristics of the land structure, with a view to defining critical regions, economically occupied regions and regions in the occupation stage.

The financial resources for financing the land reform will come from the National Land Reform Fund made up, among other sources, by the proceeds of the collection of the Improvement Contribution assessed by the Federal Government, in addition to 3% of the Tax Revenue and Internal and external donations and loans.

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