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Fighting Inflation in Brazil (1958-67): an economic and political view of the gradualist stabilisation plans

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Introduction

In the late Fifties and beginning of the Sixties, Brazilian policy-makers developed the so-called *gradualist stabilisation programme*, which was based on the idea that fighting inflation shouldn't involve recession. The gradualist stabilisation programme consisted on an effort to reduce inflation gradually instead of trying a deflationary shock. Such a strategy involved not so tight monetary and fiscal policies as in the case of a typical International Monetary Fund supported stabilisation plan, so that the country could stabilise prices and simultaneously keep growing fast. Therefore, from this point on, gradualism started to be the main guideline in the most important Brazilian stabilisation plans, whatever the political view of the government. It was first employed in the *Monetary Stabilisation Programme* of 1958 during the *developmentalist* presidency of Juscelino Kubitschek (1956-61). Then, it reappeared in the *Three-Year Plan* (1963) during João Goulart's left wing presidentialist term (1963-64) and was also at the core of the *Government's Economic Action Plan* (1964-67) of the right wing dictatorship that was established in Brazil after the 1964 *coup d'état*.

The idea of fighting inflation without causing a recession was something that was not completely new in the world economy during the Post-World War period. In fact, this idea was in line with the economic theory and the economic policy-making of

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that time. What was different in the Brazilian gradualist stabilisation plans was the fact that the Brazilian policy-makers decided to fight inflation in a gradual way even in a context of very high inflation rates. It is also worth mentioning that this gradualist stabilisation strategy was to a large extent not followed by the other Latin American countries. In this sense, the Brazilian gradualist stabilisation plans of the late Fifties and beginning of the Sixties were fundamentally a specific way of fighting inflation when compared with the international experience.

The aim of this article is to present and analyse the core policies adopted in the three gradualist stabilisation programmes above mentioned: the *Monetary Stabilisation Programme* (1958), the *Three-Year Plan* (1962) and the *Government's Economic Action Plan* (1964). Based on this analysis, it will be discussed if it is possible to identify a pattern in these three gradualist stabilisation plans. More specifically, it will be analysed whether or not it is possible to define a general idea of what a gradualist stabilisation plan might be. In addition to this discussion, it is also intended to present and compare the reasons why the gradualist strategy was chosen instead of a deflationary shock therapy. This is an important question to answer since the three plans were adopted in very different political and economic contexts.

The article is divided in four parts besides this introduction and the conclusions. The first gives an overview of the Brazilian economy from 1946-73 and introduces the main political and economic facts that led to the formulation of the first gradualist stabilisation plan in the year 1958. The second section presents the main policies adopted by the *Monetary Stabilisation Programme* (1958) and discusses the reactions to the plans. The third consists on the presentation of the core policies of the *Three-Year Plan* (1962) and the *Government's Economic Action Plan* (1964) and the discussion of the contexts in which they were introduced and the reactions that they generated. Finally, the fourth section consists on a comparative analysis of the main macroeconomic policies adopted by the three plans. In this section, it is shown that it is not possible to identify a general pattern from these plans since there are more points of difference than similarities between them. However, it is concluded that all three gradualist plans were elaborated for the same reason, namely an attempt to simultaneously obtain external credit without having to impose a deflationary shock.

I – The Brazilian Economy (1946-73): a general view

From the end of World War II on, Brazil experienced a process of accelerated modernisation that lasted over the next three decades. During this period, economic growth was led by the implementation of the durable goods industry and by public sector investments in infrastructure. Output growth was high throughout the period extending from 1946 to 1973, so that the GDP growth rates were above 5% per year in 20 of these 28 years. At that time, this rapid growth was seen by most of the public opinion as indispensable to overcome the country's economic backwardness, especially given the high population growth rate between 2.7% and 2.9% per year[3]. Given this high population growth, the more relevant indicator of growth to analyse this period is the GDP per capita, which was zero or negative in only 5 years (see table 1).

However, the period was also marked by serious economic problems due to inflationary pressures and frequent balance of payments crises. At the same time, the young democracy established in 1946 got consolidated, but the constant threat of a *coup'état* finally led to the rise of a military government in the year 1964. In this sense, the political weakness of the democratic period before the military rise (1946-64) was very important to prevent the adoption of shock treatments in order to stabilise the economy, paving the way for gradualist stabilisation experiments. [4]

This article studies the period from 1958 to 1967. This period can be divided in two phases regarding economic growth rates: from 1957 to 1962, GDP growth accelerated from 6.6% to 10.8% per year, while from 1963 to 1967 the rate of growth ranged from 0.6% to 4.2% per year. In the first phase, the Juscelino Kubitschek (JK) economic policies were crucial to foster these growth rates thanks to the investments of

[3] The main studies on this phenomenon were made by Castro (1993) and Erber (2011). Erber (2011) developed the concept of a *development convention* to express ideas that are shared by large groups without the need of expressing them formally. Accordingly, during the period extending from 1946 to 1980 a growth rate above 5% per year was considered normal and even essential for large segments of public opinion, is acceptable even live with high inflation for some years not to interrupt the process. The traumatic experience of living with high inflation in the 1980s and early 1990s led to cultural change, with the adoption of a new development agreement, which since then priorizes the protection of relatively low inflation rates (below 6% pa) , albeit at the expense of output losses. For a summary of the behavior of Brazilian inflation before and during the high inflation period, see SA-EARP (1996).

[4] For an overview of the period, see Fishlow (1980), Baer (2001), Sola (1982) and Skidmore (1967; 1990).

the *Targets Plan*[5] and the construction of new capital (Brasilia). However, this phase was also marked by the deterioration of the public finances and balance of payments difficulties. Moreover, inflation rates exceeded the threshold of 25% per year. (SA-EARP, 2005).

Table 1 - Growth and inflation 1946-1973

year	GDP[6]	GDP per capita[7]	annual inflation[8]
1946	*11.6*	*8.9*	*23.7*
1947	*2.4*	*0*	*2.2*
1948	*9.7*	*7.0*	*7.4*
1949	*7.7*	*5.0*	*12.2*
1950	*6.8*	*3.9*	*13.4*
1951	*4.9*	*2.0*	*12.5*
1952	*7.3*	*4.2*	*11.2*
1953	*4.7*	*1,6*	*21,6*
1954	*7,8*	*4,6*	*25,1*
1955	*8,8*	*5,7*	*12,2*
1956	**2,9**	**-0,1**	**26,1**
1957	**7,7**	**4,4**	**5,4**
1958	**10,8**	**7,4**	**26,8**
1959	**9,8**	**6,5**	**37,7**
1960	**9,4**	**6,1**	**30.7**
1961	**8.6**	**5.4**	**50.2**
1962	**6.6**	**3.4**	**54.1**
1963	**0.6**	**-0.3**	**82.0**
1964	**3.4**	**0.3**	**86.1**
1965	**2.4**	**-0.1**	**36.1**
1966	**6.7**	**3.7**	**37.0**
1967	**4.2**	**1.3**	**24.3**
1968	*9.8*	*6.8*	*24.5*
1969	*9.5*	*6.6*	*19.0*
1970	*10.4*	*7.5*	*19.5*
1971	*11.3*	*8.4*	*19.5*
1972	*11.9*	*9.1*	*15.7*
1973	*14.0*	*11.1*	*16.3*

Source: IPEADATA

The weak democracy of the 1946-64 years was marked by the dominance of a political coalition that emerged in the first Getúlio Vargas government (1930-1945). The two dominant parties were the conservative Social Democratic Party (PSD) and the

[5] The Targets Plan was a programme of public and private investment for 30 sectors of the economy and was carried out almost entirely. However, problems occurred for funding it since a portion of its resources was redirected towards the construction of Brasilia.

[6] Growth rate of GDP, real values in 2010.

[7] Growth rate of GDP per capita, real values in 2010.

[8] General Price Index, Internal Availability.

Brazilian Labor Party PTB), a party linked to the trade unions. The PSD-PTB coalition won the 1945, 1950 and 1955 elections, frustrating the opposition, which was led by a party with strong penetration in the middle classes, the National Democratic Union (UDN). Given its electoral failures, the UDN rapidly started to advocate and incite a military *coup de état*.[9]

An example of the democracy's fragility was the government's difficulty to consolidate a political basis in the Parliament. Thus, the federal government political alliances had to be built by granting privileges to state Governors. The federal government had to sustain these political alliances and privileges even at the expense of a loss of effectiveness in its economic policies[10].

Another important constraint generated by this type of alliance was the difficulty to raise taxes and cut subsidies (oil and wheat). For this reason the federal government was forced to seek alternatives like for instance paper currency issuing or the so-called *exchange rate confiscation*. The exchange rate confiscation was a result of the exchange rate system that was implemented in 1954, which was based on the use of different exchange rates. In this sense, the exchange rate confiscation consisted on the revenues obtained by the government through the use of this multiple exchange rate system[11]. Taken into account that this mechanism became a crucial source of revenues for the government and that there were sectors losing and winning with the exchange rate differentials, it became impossible to abolish this system without affecting many private interests and seriously damaging public finances. In this sense, in times of currency crises it was better for the government to ask for help at the IMF than to try to change the system. The exchange rate system was unified only in the year 1961.

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[9] In the only election won by UDN, in 1960, the president-elect, Janio Quadros resigned after just one semester, so that the vice-president John Goulart came to office. Goulart was the leader of the PTB party that opposed the UDN. See Skidmore (1967).

[10] An example was the granting of the presidency of the Bank of Brazil, a state bank, to politicians linked to the state of Sao Paulo, which normally practiced a generous credit expansion policy, even in times when the monetary authority - the SUMOC - wanted to reduce the money supply. This precluded the application of restrictive monetary policies. It should be recalled that Brazil didn't have a Central Bank at that time, so that the Bank of Brazil and SUMOC the central bank roles. This *labour division* in two different institutions usually resulted in lack of coordination between them.

[11] This system was implemented in 1954 through the instruction 70 of SUMOC, which instituted eight different exchange rates.

During the Kubitschek's government, elected by the PSD-PTB coalition, the public expenses grew much higher than what was expected at first. The construction of Brasília (the new Brazilian capital) and the coffee purchases made in 1958 (due to a sharp fall in coffee prices) were not initially provided in the government's planning, but were considered politically unavoidable. Unable to reduce expenses or raise taxes, the government tried to get credit abroad. Therefore, the government approached the IMF in 1958 in order to sign a stand-by arrangement. The stand-by arrangement was signed, but it soon became clear that the conditions imposed would put at risk the continuity of the Targets Plan and could cause serious political tensions. The IMF demanded for instance the unification of exchange rates, a measure that would deprive the government of a crucial source of revenues. Furthermore, it would also be necessary to adopt tight monetary and fiscal policies to curtail inflation rates. Finally, the Fund had also a bad opinion about the Brazilian coffee policy.

In this context, the then Finance Minister (José Maria Alkmim) was replaced by Lucas Lopes and Roberto Campos replaced Lopes in the presidency of the National Development Bank (BNDE). The Lopes-Campos duo had technical experience and was given the mission to formulate a stabilisation plan that could be accepted by the IMF without putting at risk the Targets Plan or imposing the adoption of measures that could cause political problems internally. In other words, the duo had the mission of formulating a plan that could be accepted by the IMF and also by the internal political actors (SOLA, 1998). It was in this context and for this purpose that the Monetary Stabilisation Programme was formulated with a gradualist stabilisation strategy.

II– The *Monetary Stabilisation Programme (1958)*: the first gradualist plan

II.1 – The plan

The *Monetary Stabilisation Programme* (*Programa de Estabilização Monetária* or simply PEM) was launched in October 1958[12]. Its main purpose was to curtail the

[12] The plan was sent to the Parliament in October 1958.

inflation rates without putting into risk the execution of the investments of the Targets Plan. In reality, it was supposed to give more consistency to the Targets Plan through the provision of non-inflationary means to finance the Plan's investments[13] (PEM, 1958: III).

In terms of the causes of inflation, the programme identified demand-pull inflation due to an excessive growth of the means of payments (paper currency and demand deposits). This excessive money growth was for instance a consequence of budget deficits that had to be financed through money issues by the monetary authorities. These money issues resulting from the fiscal deficits would then arrive at the commercial banks allowing them to lend more and thus increase their customer expenses (PEM, 1958: 18). In this sense, it was concluded that "in order to reduce the prices growth it was necessary to reduce the increases of the means of payments to rates closer to the average rates of growth of the real output" [14] (PEM, 1958: 19). Moreover, it was also concluded that it was necessary to eliminate the fiscal imbalances, so that pressures for money issuing could get reduced.

Nevertheless, the programme also identified cost-push inflation. According to the document, until 1954 Brazil had what was called *investment inflation*, an inflation caused by attempts of the government and the private sector to invest beyond the propensity to save, the net resources coming from abroad or the real availability of the needed factors. This sort of inflation could have positive effects in the long run because of the structural transformations that it may cause. The problem was that from 1954 on this inflation became fundamentally cost-push inflation, a type of inflation characterized by the wage-prices spiral and thus useless to the country. The emergence of cost-push

[13] One of the government's major concerns when launching the Monetary Stabilisation Programme was to assure that the emergence of the programme wouldn't mean the abandonment of the investments of the Targets Plan. Therefore, this idea that the programme was not a threat to the continuity of the Targets Plan appeared several times throughout the Monetary Stabilisation Programme document. In this sense, it was argued for instance that the main sources of fiscal deficits were public expenses not related to the investments of the Targets Plan (PEM, 1958: V).

[14] According to the document, this idea that the money supply growth rate should be close to real output growth rate was enforced by the fact that in the decade before the plan was launched the average rate of growth of the Brazilian total real output was 5.1%, the average rate of growth of the money supply was 20,4% and the average prices growth per year was 14.4%. The document concluded that this point showed the effects of the excessive money supply growth on the inflation rates.

inflation was due exactly to the rising inflation from the previous period since it caused a growing social unrest that led to pressures for higher wages. Therefore, the Monetary Stabilisation Programme had also to deal with these growing demands for higher wages in order to control inflation (PEM, 1958: 19).

The problem of how to deal with the wages was technically the very reason why the Monetary Stabilisation Programme was based on a gradual approach (SOLA, 1998: 193). The programme was supposed to be developed in two phases. The first phase - called *Transition and Readjustment* – should involve a sharp reduction in inflation rates. However, it was recognised that in the short run some wage increases were inevitable to compensate the real income losses of certain groups. In this sense, some monetary expansion had to take place in order to absorb these wage readjustments without a rise in unemployment levels (PEM, 1958: II). In other words, in this first phase it was not possible to have the means of payments growing at a rate closer to the real output growth rate because that would cause an upsurge in unemployment[15].

After the readjustments of the first phase, the second phase – called *Stabilisation* – should start at the beginning of 1960. The main guideline of this phase was precisely to limit the expansion of the means of payments to the same rate of growth of the real output. This measure was supposed to be capable of keeping the internal prices stable as much as promoting the balance of payments equilibrium (PEM, 1958: II).

The monetary policy was based on the setting of ceilings to the expansion of the means of payments and of the credit. The means of payments were supposed to reach in December 1958 a level 4% higher than the one prevailing in June 1958. For 1959, the means of payments and the paper currency balances should be only 10% higher than the level of the last day of 1958[16] (PEM, 1958: 1-2).

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[15] The first phase had the purpose of promoting economic and social adjustments. In the economic side, the aim was to correct the distortions caused by inflation in terms of for instance income distribution and the prices within the foreign sector. In relation to the social adjustments, the aim was to make these inevitable nominal wage increases actually become real wage gains to the workers. It was believed that this purpose should be achieved by the stabilisation policies that were supposed to avoid the increases in the cost of living that usually happened after a rise in the nominal minimum wage (PEM, 1958: II).

16 In terms of the paper currency issuing, the programme planned a contraction of 2.076 millions of cruzeiros from the beginning of the plan until December 1958.

In terms of the Bank of Brazil credit policy, the expansion towards financing the Treasury was supposed to be low since the 1959 deficit was expected to be small. In terms of the credit to the private sector, it was supposed to grow fast until the end of 1958, slowdown in the first four months of 1959 and then start to grow again after May. The commercial banks credit policy was not under the government's control, but the government developed forecasts of this variable future behaviour, so that it was ready to act if the credit expansion started to grow faster than expected (PEM, 1958: 2-5).

The fiscal policy had a very important role in the plan. According to the then Finance Minister Lucas Lopes, the PEM was fundamentally a fiscal reform (LOPES, 1991: 235). The fiscal policy guidelines were for instance to avoid a big deficit in the Treasury's financial operations in the year 1959, to guarantee that the expenses that exceed the revenues would be financed through non-inflationary means[17] and to rationalize the public expenses in order to broaden the relative share of the public investments (PEM, 1958: 8). However, the most important part of the fiscal policy was a mini tax reform. This tax reform was expected to raise the revenues obtained through the income, consumption and stamp taxes in a total of 12.5 billions of cruzeiros in 1959. This increase would represent a 9.25% increase in the total revenue previously expected for 1959 (PEM, 1958: 8-10).

In terms of the balance of payments policies, there were some basic guidelines, but this part of the document was shorter and lacked in substance in comparison to other parts of the document. It was recognised that in the following years there was going to be a huge repayment of foreign loans and the need of foreign credit for investments in specific sectors, so that the balance of payments would be under pressure. The document pointed out that the reduction in the inflation rates would help adjust the foreign accounts by reducing the export's costs of production and by easing the access to foreign credit. However, the programme signalled the need of fostering exports. In this sense, there were some specific guidelines for the exchange rate policy. The proposal was to gradually eliminate the exchange rate subsidies in order to reduce the disparities between the internal and the external value of the currency (PEM, 1958: 14-

[17] Accordingly, the government wanted to increase the emission of public bills as a way of financing the public deficits and thus to reduce the need of financing them through paper currency emissions (PEM, 1958: 9).

15). For this purpose, there were devaluations in August 1958 and January 1959 and some exports were allowed to be traded in the free market (CAMPOS, 1994: 357-358). The idea was twofold: 1) to move the exchange rate towards a realistic value; 2) to continue the process of simplification of Brazil's exchange rate system, which was started in 1957 with the reduction in the number of the multiple exchange rates from five to three.

In terms of the wage policy, most of the programme's guidelines were devoted to the minimum wage policy. In this sense, the programme was critical to the minimum wage policy that was started in 1951 since it was based on wage increases above inflation. It was argued that nominal wage increases above inflation didn't actually mean a real wage rise taken into account that these increases are always followed by a rise in the cost of living. Therefore, the programme recommendation for 1959 was to increase the nominal minimum wage without providing real gains to the workers. In other words, the nominal minimum wage increase should be equivalent to the accumulated inflation since the last time that the minimum wage had been raised (July 1956). More precisely, the purpose was to raise the real minimum wage to the level of July 1956, what meant a 37% increase (PEM, 1958: 13).

It is important to acknowledge that the policy-makers that elaborated the PEM were not keen on the idea of increasing the nominal minimum wage in such a way because they believed that it could motivate other workers claims for readjustments and also a drop in profits and investments. If they could, they would have given a much lower wage increase, but they were unable because of political reasons: "...the preceding wage increases created the expectation that future increases are also going to be substantial. Therefore, it became politically quite difficult to adopt a conservative criterion for the minimum wage adjustments" (PEM 1958: 57). That is why the programme mentioned that some wage increases were inevitable in the short run. In this context, that was also the reason why it was not possible to make the means payments grow at a rate closer to the one of the real output during the first phase of the stabilisation programme. However, the programme's idea was that in the long run wages should grow in line with productivity (PEM, 1958: VIII).

II.2 – The reactions to the plan

In sum, as it was mentioned before, the Programme tried to conciliate the Targets Plan with the IMF requirements of a stabilisation plan. In other words, it was an effort to conciliate the internal and external demands that the government was facing.

However, the reactions to the programme were not positive. Internally, the coffee producers were for instance critical to the policies implemented by the Monetary Stabilisation Programme. In particular, they were upset by the changes in the coffee policy in relation to the one led by the former Finance Minister José Maria Alkmin, what in practice meant a reduction in the amount of coffee that would be bought by the government in the 1958-59 harvest. In this sense, the sector wanted for instance funding to replace old plantations for new ones, the setting of a minimum price above the international and a favourable exchange rate to import the goods necessary to the coffee production. However, José Maria Alkmin's coffee policy was seen by the economic team as too much complacent with the coffee producers and not compatible with the policies of the stabilisation programme. (CAMPOS, 1994: 354). Furthermore, the establishment of a *more rational coffee* policy was mandatory if the government wanted to get the support of the IMF (LOPES, 1991: 248).

The industrial sector also criticised the plan because of the credit controls and the rise in the income tax. According to the core publication[18] of the National Industry Confederation (CNI), in underdeveloped countries like Brazil inflation due to monetary expansion had positive effects in fostering economic development. In these countries, the only limit to economic growth and investment was a shortage of savings. In this sense, inflation caused by monetary emissions would mean an income transfer from the sector that consumes to the industry (the sector that save and invest), so that it would increase the savings and the investment in the economy (SARETTA, 2010: 14-16). Further, the trade unions capacity to increase wages in order to compensate the income transfer was considered sufficiently low to guarantee even in the long run the positive effects of inflation in increasing savings (SARETTA, 2010: 17 *apud* CNI, 1958: 31).

[18] This publication was called *Desenvolvimento e Conjuntura.*

Though a rise in inflation due to monetary expansion was seen as having positive effects, inflationary pressures caused by wage increases were considered deleterious to economic development since they meant an income transfer from the *investing sector* to the *consuming sector*. Therefore, the CNI argued that the inflation upsurge in Brazil at that time was due to increases in public sector wages and in the minimum wage, so that the plan should have concentrated on wage controls instead of controlling monetary emissions. In this sense, the main conclusion was that measures proposed by the PEM to fight inflation mistakenly favoured consumption instead of savings and investment (SARETTA, 2010: 7).

However, the government was politically unable to adopt a more conservative wage policy, a point that was recognised by the policy-makers in the program's document. The JK's political coalition was formed by the Social Democratic Party (PSD) and the Brazilian Labour Party (PTB) and this coalition had the majority of votes in the Parliament. In this context, the important point was that the PTB was the party of the vice-president João Goulart and was strongly related to the trade unions. In other words, a more conservative policy would be considered completely unacceptable by the party and such a proposal would have political consequences to the government (SOLA, 1998: 217-218; 419).

The problem was that besides the internal antagonism to the programme, it was also criticised by the International Monetary Fund. The changes in Brazil's exchange rate system were far from the exchange rate unification demanded by the Fund. Some crucial subsidies (like oil and wheat) were not eliminated and despite the devaluations in the exchange rate, they were not enough to move the exchange rate to a realistic value. Thus, the Fund demanded further exchange rate adjustments (CAMPOS, 1994: 357-358).

Moreover, the IMF was also critical to the coffee policy and to the fact that there were some public tariffs that were repressed. In sum, the Fund identified relative price distortions that should be eliminated by for instance exchange rate devaluations, the elimination of exchange rates subsidies and public tariffs rises, a sort of measures that became known as *corrective inflation* measures (CAMPOS, 1994: 357-359). The problem was that a broader exchange rate reform and changes in the coffee policy were

measures that were hard to implement in Brazil's prevailing political context. The Brazilian authorities tried to explain that to the IMF, but the Fund was not flexible enough[19]. The antagonisms to the plan would evolve into resistance to some of its core measures. The coffee producers organized for instance the so called *Productions March*, a demonstration of several trucks and tractors in front of the presidential residence. Moreover, as the sector had representatives in the Parliament what translated into political pressure on the government. According to the then Finance Minister Lucas Lopes, this sector's lobby was the strongest and hardest that the government had to face (LOPES, 1991: 244; 247).

There were also huge problems in the Parliament to approve some of the programme's measures. The Parliament voted expenses 13% above the planned levels and the fiscal reforms that could increase the revenues were not voted. The programme's proposal of increasing the public sector wages in 30% was respected, but it was voted on January 1959 that these increases would be immediately implemented instead of being postponed to July as it was the government's intention. Further, the Parliament decided on December 1959 that the minimum wage increase would be of 57.9 %, a level much above what was proposed by the stabilisation programme. As a result, around May 1959 the budget deficit was 3 times higher than what it was expected to be for the whole year. Moreover, these wage increases plus the rises in some public sector tariffs and the restrictive monetary and credit policies resulted in a liquidity crisis from April to May 1959 that led to protests from the industrial sector against the programme. The industrial sector also opposed the fiscal reform that would result in increases in the direct taxes (SOLA, 1998: 210-213).

At the same time, after months of negotiation the IMF kept inflexible in relation to the *corrective inflation* measures. According to Campos (1994), the Fund wanted to keep negotiating, but they it was a bit intransigent in relation to these matters. The

[19] Roberto Campos (1967) complained that the IMF at that time didn't pay enough attention to the political pitfalls of their stabilisation programmes. For instance, the corrective inflation measures caused in the first phase of the stabilisation programme a cost of living upsurge that affected mostly the low-income groups and demoralized politically the plan (CAMPOS, 1967: 119).

problem was that the long period of negotiation and the IMF's inflexibility strengthen nationalistic positions against an agreement with the Fund (CAMPOS, 1994: 359-363).

The internal and external difficulties ended in the government's decision to give up the Monetary Stabilisation Plan and to breakdown with the IMF. It was perceived that there were no political conditions to implement a stabilisation programme since no sector wanted to pay or share the costs of stabilisation and all sectors seemed to be capable of blocking the stabilisation efforts. Therefore, the continuity of economic growth and of the Targets Plan was the way to avoid the collapse of the political coalition and to guarantee the necessary governability (SOLA, 1998: 202; 223).

III – The gradualist stabilisation plans of the 1960s

III.1 – The period 1961-1962

The 1960 presidential elections were the only electoral win of the UDN, but it did not lead to an effective exercise of power. The elected president, Janio Quadros, took office in the beginning of 1961 and followed random policies. On the economic front, he eliminated the multiple exchange rates and initiated a program that was intended to stabilise the economy. In this respect, he also initiated negotiations with the IMF. These decisions were well regarded by the U.S. government. However, he also adopted a foreign policy that was intended to deepen the Brazilian relationship with the socialist countries and the Third World Group, a policy that deeply displeased the US government.

In search of an increase of his presidential powers, Quadros resigned the presidency in August 1961 wondering that he would be able to return with enhanced powers. However, this strategy failed. The intense political and military mobilisation of the country led to a political commitment in which the vice president Goulart finally came to office, but with reduced powers since the political regime was changed to a parliamentary regime. The consequence was that all the attention of the country was mobilised to the referendum of January 1963 that was going to define whether or not the presidentialist regime would be restored. During the period of about a year and a half of

the parliamentary regime the various offices were unable to give a direction to the economy, the growth rate fell sharply, inflation rose and the balance of payments deteriorated.

III.2 – The *Three-Year Plan* (1962)

The Plan was formulated during the referendum campaign and was an attempt to show that Goulart would be able to face the Brazilian economic problems. It was thus used as an important propaganda element during the campaign. The presidentialist option was ultimately successful and with the beginning of Goulart's presidentialist term, the government tried to negotiate with the U.S. government and the IMF. However, the State Department kept on with a bad opinion on Goulart: the fear of the Kennedy administration was that Brazil would become a new Cuba. The secretary Robert Kennedy during his visit to Brazil in 1962, made clear that his government hoped to clear steps towards an anticommunist stance. In fact, the US government demanded a serious of actions from the Brazilian government otherwise it would not provide financial aid. One of the demands was the dismissal of supposed communists that belonged to the Goulart's government team. Another requirement was the adoption of a stabilisation programme and the support of the IMF (LOUREIRO, 2011).

III.2.i – The plan[20]

In the end of 1962, the inflation rates reached 50% and the output growth rates were decelerating. Moreover, there was also the need of foreign credit to face the balance of payments difficulties. To get this credit, the Brazilian government needed the aid of the US government, but the John Kennedy administration was severely critical to João Goulart. It was in this adverse context that the Three-Year Plan (*Plano Trienal)* was developed in 1962 to be the economic programme of the three year period (1963-

[20] The presentation of the main measures adopted by the Three-Year Plan and the Paeg follows closely the one presented in Bastian (2011).

65) of João Goulart's presidentialist government[21]. The plan was formulated by Celso Furtado, Brazil's most famous structuralist economist[22].

In fact, the plan's most important aspect was the purpose of stabilising the prices without causing a recession. Although the inflation rates were historically high, it was unthinkable to solve the problem through a recession. After the high economic growth rates of the JK government there was the emergence of almost a consensus that the Brazilian economy had to keep growing fast (CASTRO, 1993: 187-188; CASTRO, 2000: 837). In this sense, the plan's document was quite clear in relation to this choice of not allowing a recession to happen: "If fighting the inflationary pressures is so important a task, why then one refuses to stabilise the prices in a fast way instead of doing it gradually? The reason for that is because obtaining a high output growth rate is the most important economic target and a fast deflation can put this target in risk"(THREE-YEAR PLAN, 2011: 78). Therefore, the plan presented the following guidelines: 1) income growth rates of around 7% per year; 2) gradual strategy of stabilisation, so that the 1963 inflation rate should be half of the previous year inflation and the 1965 inflation rate should reach 10% (THREE-YEAR PLAN, 2011: 43).

According to the plan's interpretation, the Brazilian inflation was caused by two imbalances: 1) public sector imbalances; 2) foreign sector imbalances. The first referred to the public sector deficits that had been caused mainly by the fast growth of public sector investments without the necessary means to finance them. These deficits caused excessive money issuing that by its turn caused a rise in prices. In sum, the public sector imbalances were causing demand-pull inflation (THREE-YEAR PLAN, 2011: 46; 70).

The foreign sector imbalances were due to Brazil's chronic insufficiency in terms of its import's capacity. This chronic problem was fundamentally caused by the changes in Brazil's economy as a consequence of the ongoing industrialisation process. This sort of inflation could only be overcome in the long-run with the deepening of the industrialisation process and with the implementation of structural reforms. Therefore,

[21] In 2011, the *International Celso Furtado Center for Development Policies* (*Centro Celso Furtado*) published the complete version of the Three-Year Plan original document. This article was based on this 2011 edition.

[22] The term *structuralist* refers to the Latin American Structuralist School.

this type of inflation can be labelled *structural inflation* (THREE-YEAR PLAN, 2011: 67).

The fight against the structural inflation would be based in productive investments and structural reforms. The investments were intended to foster the internal supply in order to avoid the imbalances that could cause inflationary pressures. In this sense, there were planned investments to sectors such as Agriculture, Industry, Energy and Transport (THREE-YEAR PLAN, 2011: 90; 94). The structural reforms were supposed to improve the country's institutional setting and thus improve the government's policy-making efficiency (THREE-YEAR PLAN, 2011: 436). The plan's document listed for instance the need of fiscal, administrative and banking reforms. However, the most important and controversial was the Agrarian Reform

The programme's strategy to face the demand-pull inflation was based on monetary and fiscal control. In terms of the fiscal policy, the government calculated that without a cut in the potential fiscal deficit estimated for 1963 the country would reach an inflation rate of 100%. To avoid this hyperinflationary scenario, the plan established that 1/3 of the expenses had to be cut in the year 1963 (THREE-YEAR PLAN, 2011: 100).

Another measure relative to the public sector was the elimination of the wheat, oil and oil lubricants subsidies. With this measure, the government was expected to save more than 60 billion of cruzeiros in the year 1963 (THREE-YEAR PLAN, 2011: 101). Moreover, this policy was part of the so called *corrective inflation* measures usually advocated by the IMF, so that its inclusion in the stabilisation plan would surely be well regarded by the Fund's Board.

The monetary and credit measures were associated to a monetary programming based on the fiscal targets above mentioned. The means of payments expansion for 1963 was calculated in 34% because that would be compatible with the stabilisation of the Public Expenses/ GDP ratio (in the level of 1963), an output growth rate of 7% and an inflation rate of 25%. The credit to the private sector should grow in line with the inflation rate plus the output growth rate and the rediscount and compulsory deposits should be managed based on this ceiling to the private sector credit (THREE-YEAR PLAN, 2011: 47).

The policies aimed at the foreign sector were supposed to help increase the country's import capacity. The programme's document explicitly demonstrated the huge fall in Brazil's import capacity in the beginning of the sixties. Moreover, it showed that the situation wouldn't be better during the 1963-65 years: for this period, the plan estimated that Brazil would have an accumulated current account deficit of 545 million dollars and would have to make payments of 1.66 billion dollars (THREE-YEAR PLAN, 2011: 111). In this context, the programme indicated the urgent need of obtaining external credit on order to raise the country's import capacity. Moreover, it also showed that fostering the exports could also be helpful to accomplish this task. For this purpose, it would be necessary to have a *realistic* exchange rate (THREE-YEAR PLAN, 2011: 80; 107-111; 133-135).

Finally, the plan didn't have a proper wage policy. It is true that there was a vague guideline that real wages should grow in line with the economy's productivity plus the adjustments in the living costs (THREE-YEAR PLAN, 2011: 43). Moreover, the plan proposed a 40% wage increase for the public sector servants in the year 1963, a value lower than the 1962 inflation rate. However, there were no actual policy guidelines to the wages for the period 1963-65.

III.2.i – The reactions to the plan

At first, the government showed a strong commitment to the plan's policies. In this respect, the corrective inflation measures were put in practice and the fiscal policy remained restrictive throughout the first quarter (LARA-RESENDE, 1982, 763-765). In this context, the plan got a welcome reception. The North American government also liked the Brazilian government struggles to stabilise prices and a visit of the IMF team to Brazil was scheduled.

The problem was that in the first quarter of 1963 the inflation rate reached 16%, what was more than half of the inflation rate planned for the whole year. This result was due to the corrective inflation measures taken into account that they caused a rise of 100% in the wheat price, 70% in the domestic price of oil and a 56.25% rise in the

minimum wage (LARA-RESENDE, 1982: p.763; MACEDO, 1970, p. 62; MELO et al., 2008, p. 95).

Taken into account that the inflation rate in 1962 was around 50% and the inflation rate in the first quarter of 1963 was 16%, the workers didn't accept the proposal of a 40% rise. In fact, the workers had a lot of expectations on the Goulart government because the president had strong political links with the trade unions. Since in the fast growth period of the late Fifties the wages grew less than the labour productivity[23], the workers were hopeful that a left-wing government of the PTB would be generous to their demands. This situation put the Goulart administration under strong pressure because high wage increases would put in risk the stabilisation programme and would inflate the conservative sectors.

In this respect, the government tried to sustain the moderate wage increase, but the Parliament voted a 70% increase for the public sector. Therefore, "the cost shock from the corrective inflation measures passed through the nominal wages and caused a wage-price spiral" (MELO et al., 2008: 102). Thus, the plan failed in its stabilisation attempt though the monetary and fiscal policies were kept under control at least during the first quarter of the year.

There was however another factor that contributed to the plan's flop. The Goulart's presidentialist government started in an urgent need of foreign credit to face the balance of payments problems. In order to get that credit, the government fulfilled almost all the requirements that the John Kennedy administration imposed. When Brazil's Finance Minister travelled to the United States in March 1963 to negotiate new loans and the rescheduling of the debt, he was confident that the North American government would cooperate. Nevertheless, the aid that was offered was too small and not capable of relieving Brazil's balance of payments difficulties. Furthermore, the IMF thought that the gradualist plan was a too lax stabilisation programme. Taking into account this prejudice against the gradualist plan and the spreading of the inflationary effects after the public wage rise, the Fund refused to sign a stand-by agreement with Brazil. The signature of a stand-by agreement was a key to Brazil's intentions of obtaining funds abroad (LOUREIRO, 2011: 3-16; RIBEIRO, 2006: 200).

[23] For further details, see Colistete (2007).

The Three-Year Plan was abandoned in the middle of the year. In this context, the inflation upsurge and the ongoing balance of payments crisis the scenario developed into a political crisis. After trying to govern in a moderate way during the first semester, João Goulart started to approach the political groups that were historically his allies in the left, what was badly regarded by the US government and the Brazilian conservative groups. The political tensions grew up and culminated in the military *coup d'état* of April 1964[24].

III.3 - The *Government Economic Action Programme* (1964)

After the military *coup d'état* of April 1964, the Marshal Humberto Castello Branco became Brazil's president with a term from 15 April 1964 to 20 January 1967. Castello Branco appointed the economists Roberto Campos and Octavio Gouveia de Bulhões as Finance Minister and Planning Minister respectively. Under their direction, the *Government Economic Action Programme* (*Programa de Ação Econômica do Governo* or simply PAEG) was launched in November 1964[25]. The plan had to face a challenging economic scenario. In 1963, the inflation rate was 90%, the output growth rate was a modest 0.6% and the balance of payments kept in crisis.

It is worth noting the sympathy that the U.S. government had for the new Brazilian government. In comparison to what happened during the Goulart's administration, the US State Department's attitude changed dramatically, so that it supported a programme that was far from corresponding to what the IMF staff had demanded from the country in previous years (LOUREIRO, 2011). Thanks to this positive attitude from the US government, the PAEG faced a much more favourable external scenario than the PEM and the Three-Year Plan.

The PAEG strategy consisted on a stabilisation programme and a serious of economic reforms that were intended change the main economic institutions of the country. The major reforms proposed were to a certain extent similar to the ones

[24] For further details on the political crises and the *coup d'état,* see Skidmore (1992).

25 Some of the plan's measures were put in practice shortly after Castello Branco came to office. However, the plan was officially launched only in November.

proposed by the Three-Year Plan taken into account that the PAEG planned to introduce reforms in the tax system, the financial system and in the labour market. Nevertheless, it is important to mention that the PAEG didn't identify a structural inflation, so that these reforms were not intended to curtail the structural inflation as was the case in the Three-Year Plan.

The financial system reform was inspired by the then American model and was thus based on the creation of institutions, whose lending possibilities would be limited by their fundraising sources and terms. For instance, the so called *Credit, Financing and Investment* institutions had to operate with medium-term credit and investment banks would operate in the market for long term credit.

The tax reform was based on the introduction of value added taxes on industry, commerce and services, eliminating thus the previous system of double taxation. At the same time, it was instituted the restatement on the securities, with a guaranteed return of 6% per annum above the rate of inflation. The placement of these securities has funded the public debt without it being necessary to drastically reduce the rate of inflation.

Finally, the reform of the labour market was based on the elimination of free wage bargaining in the private sector (except the minimum wage, which was adjusted periodically by law) and the change in the rules for dismissing employees. There was authoritarian intervention in the trade unions and the introduction of a wage rule, which caused the real wages fall in the next years. The compensation paid by firms in layoffs of employees has been replaced by a public fund to which employers make monthly payments, and that became the main source of funds for the housing program.

In sum, all reforms were executed and were of great importance for the economic success of the following period, which became known as the *Brazilian Economic Miracle* (1968-1973).

III.3.i - The plan:

The plan identified the fiscal deficits as the primary cause of the Brazilian inflation. The public accounts imbalances caused an excess demand that was sufficient to raise the prices. These price increases were followed by wage rises that would then spread the inflationary pressures. As a consequence, there would be a liquidity fall and thus a credit expansion to compensate it. In sum, the plan identified demand-pull

inflation due to fiscal deficits and cost-push inflation associated to the conflicting claims and their wage-price spiral effects (PAEG, 1964, 28-29).

Despite the high inflation rates, the plan didn't recommend a *shock therapy* to bring a fast and sharp reduction in these rates. In a context of 90% inflation rates, a shock therapy would require a wages freeze and a huge cut in the public deficits, so that there is no doubt that such a strategy would cause severe output losses and a rise in unemployment levels. Moreover, the plan recommended also the adoption of the *corrective inflation* measures. As these measures would necessarily cause a rise in the inflation rates in the short run, the fiscal cuts would have to be even higher in the case of a shock therapy strategy (PAEG, 1964: 33).

In addition to these technical issues, it is also important to acknowledge that the Castello Branco administration could not politically adopt a too recessive stabilisation programme. Although the plan was implemented during a dictatorship, "a sharp fall in output rates could undermine the regime's legitimacy with its supporters within society (namely the entrepreneurs and the richest groups)" (HERMANN, 2005: 73). In this sense, the stabilisation programme should not undermine the economy's propensity to invest nor cause entrepreneurial insolvencies (PAEG, 1964, 33). Thus, the government opted for a gradualist stabilisation programme, whose suggested inflation targets were 25% for the year 1965 and 10% for the year 1966 (PAEG, 1964: 33).

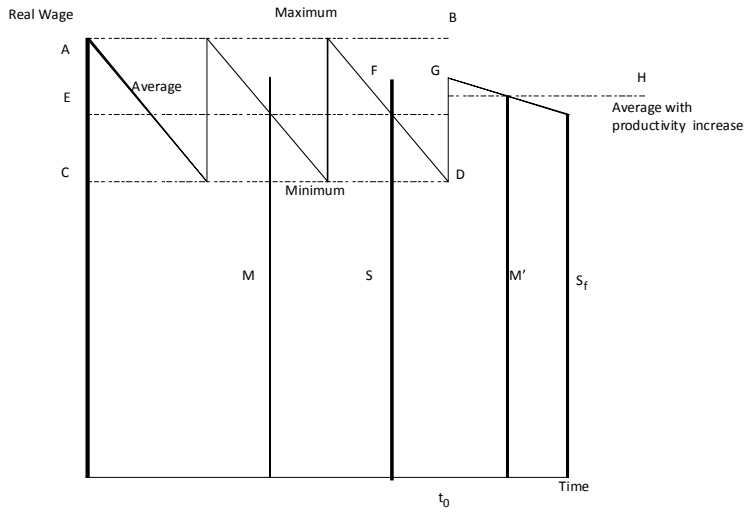
The fiscal measures were intended to cut expenses and increase revenues. The revenues were supposed to increase with the upsurge in economic growth rates. In relation to the expenses, non priority expenses should be cut and joint-stock companies deficits should be eliminated. The plan estimated a fall in the Fiscal Deficit/GDP ratio from 4% in 1964 to 2.8% in 1965. To finance the fiscal deficits without having to issue money, there were measures to reestablish the public bonds market. This market had lost its attractiveness to investors because of the so called *Usury Law (Lei da Usura)* that established a 12% ceiling to the nominal interest rate: in a context of inflation rates much above 12%, there was no incentive to buy public bonds. The PAEG revoked the Usury Law and launched bonds (ORTNs) whose value was protected from inflation through monetary correction (PAEG, 196, p. 34; 53-56; 77-80).

In terms of the monetary and credit policies, there were two basic guidelines aimed at reducing the need to issue paper currency: 1) fiscal deficits reduction; 2) control over the credit expansion to the private sector. However, it was recognised that in a context of cost-push inflation, there is the risk of a liquidity crisis, so that it is necessary to have a broader credit expansion than what would be desired. Therefore, the guideline was to control credit without causing a liquidity crisis. The credit ceilings should be readjusted proportionally to the means of payments growth rate (PAEG, 1964, p. 34).

The PAEG's wage policy main purpose was to fight against the wage-price spiral. It was believed that nominal wage increases proportional to inflation rates were one of the major causes of the wage-price spiral problem, so that such increases should not be allowed. Thus, the major guidelines of the wage policy were to limit the wage increases to the productivity increases. Moreover, it was also intended to eliminate the real wages instability without raising their average (PAEG, 1964, 34).

For this purpose, the plan developed a wage rule. This rule was based on the idea that nominal wages should be readjusted taking into account the average real wage of the last two years and not the prevailing real wage value after the last readjustment. After a nominal wage readjustment, the real wage is in its maximum level. During the readjustments interval, the real wage falls because of inflation, so that immediately before the new readjustment it reaches its minimum level. Based on the real wage maximum and minimum values, it is then possible to calculate an average real wage. The wage rule established that the nominal wages increases should just recover the average real wage value of the last two years plus an average productivity increase. Therefore, the new maximum real wage value is lower than the former maximum real wage value. However, the stabilisation programme is supposed to reduce the inflation rates and if such a reduction occurs, the minimum real wage value would be higher than the former minimum real wage level. Therefore, the average real wage was supposed to stay constant, so that workers would not have income losses. (PAEG, 1964, 84). The wage rule mechanism can be seen in graph 1.

Graph 1: PAEG's wage rule mechanism



Source: Simonsen (1974)

Finally, there were the policies aimed at improving the balance of payments results. In this respect, the plan established that the exchange rate should be *realistic* in order to stimulate the country's exports and thus enhance its imports capacity. In terms of the imports capacity, the plan also recognised the difficulties associated to the fact that 48% of the debt charges were concentrated in the years 1964 and 1965. Nevertheless, it celebrated the success obtained by the 1964 renegotiation missions with North-Americans, Europeans and Japanese creditors (PAEG, 1964, 134-144).

III.3.ii – Reactions to the plan

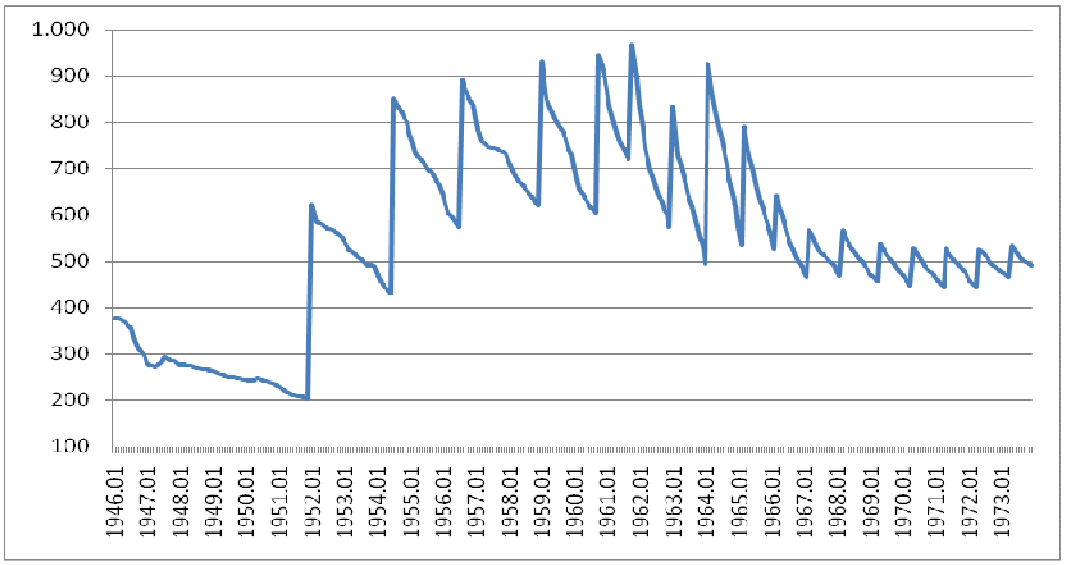
In terms of results, the PAEG was the most successful gradualist plan. Although it didn't achieve its targets, the inflation rates fell from around 90% in the end of 1963 to an average rate of 45.5% in the period 1964-67. Furthermore, the economy started to grow again (average rate of 4.2% in the period 1964-67) in contrast with the 0.6% growth rate in the year 1963 (HERMANN, 2005: 79).

The PAEG obtained these results thanks at least to two factors. The first one was the goodwill of the US government and the IMF with the Brazilian dictatorship. According to LARA-RESENDE (1982), Brazil was the fourth largest receiver of funds of the AID during the period 1964-67[26] (LARA-RESENDE, 1982, p. 782-783). Furthermore, in contrast to what happened with the PEM and the Three-Year Plan, the IMF approved the gradualist strategy of the PAEG and thus Brazil was able to sign a stand-by agreement with the Fund.

The second factor is related to a political matter. The other stabilisation programmes found it hard to stabilise because nobody wanted to pay the stabilisation costs and the government's coalition didn't have the political strength (or will) to define the winners and losers. As the PAEG was implemented in a dictatorship, it was able to end the conflicting claims problem. In this respect, the programme ended it in a regressive way by defining the workers as the main losers. The wage rule imposed the underindexation of the wages. As a result, the cost shock due to the corrective inflation measures didn't cause a wage-price spiral (LARA RESENDE, 1982: 802; MELO et al., 2008: 102-103). However, there was a huge fall in real wages. This result can be for instance seen when one looks at the evolution of the minimum real wage from 1956 to 1967 (graph 2).

[26] For further details on the US financial assistance to the Castello Branco administration, see Ribeiro (2006).

Graph 2: Minimum Real Wage (1946-1973)



Source: Ipeata, values in 2011 reais.

The graph shows that the minimum wage increases allowed workers to achieve real gains during the decade that spanned from 1952 to 1962. The rise in inflation and especially the loss of predictability of the inflation rates resulted in reductions in the workers purchasing power, so that there were strong pressures for minimum wage increases in 1963 and early 1964. The military government installed in April 1964 solved the problem of the impact of the minimum wage on costs by underestimating future inflation from 1964 to 1966. This measure helped to end the wage-price spiral and thus to reduce the inflation rates, but the constant underestimation of the inflation rates caused also the sharp fall in the minimum real wage. This pattern remained unchanged during the 1968-1973 period.

IV – The gradualist stabilisation plans: a comparative analysis

The last two sections provided information on the three gradualist plans. In this section, the main concern is to compare the plans in order to point out their similarities and differences. For this purpose, it is worth analysing the table below since it synthesizes the main aspects of each plan.

Table 2 - Gradualist Stabilisation Plans: a general view

	PEM	Three-Year Plan	Paeg
Causes of Inflation	Demand-pull inflation/ Cost-push inflation	Demand-pull inflation/ Structural inflation	Demand-pull inflation/ Cost-push inflation
Corrective inflation	No	Yes	Yes
Fiscal Policy	Fiscal adjustments	Fiscal adjustments	Fiscal adjustments
Monetary Policy	Controls on the credit and means of payments expansion	Controls on the credit and means of payments expansion	Controls on the credit and means of payments expansion
Exchange Rate Policy	Gradual move to a *realistic* exchange rate	*Realistic* exchange rate	*Realistic* exchange rate
Wage Policy	No real wage gains in the short run/ In the long run, wages should grow in line with productivity/ No wage rule	Wages should grow in line with productivity/ No wage rule	Wages should grow in line with productivity/ Establishment of a regressive wage rule

Source: Bastian & Earp

The table shows that the three gradualist plans share some similar points. However, there are also many different points.

A first source of differences between the three gradualist stabilisation plans is related to the causes of inflation. The *Government Economic Action Programme* and the *Monetary Stabilisation Plan* identified similar causes. According to these plans, the Brazilian inflation was due to demand-pull and cost-push factors. The first was related to excess money supply because of the budgetary deficits, while the second was a result of wage growth. In this context, the *Three Year Plan* also identified demand pressures due to fiscal deficits. However, the plan didn't share the diagnosis that there was cost-push inflation as a consequence of the wages growth. In spite of proposing in 1963 wage increases below the inflation rate, the plan didn't mention at any part the cost-push pressures as a major cause of inflation in Brazil, so that there were no specific policies aimed at dealing with this issue. On the other hand, the *Three-Year Plan* was the only programme that identified structural factors as an important source of inflation. These structuralist elements were such that the policy-makers that proposed the plan believed that the stability of prices would only be achieved through the establishment of structural reforms and the continuity of the industrialisation process.

The fact that all three plans identified demand-pull inflation resulted in similar monetary and fiscal policies. All three programmes seemed to follow a monetarist or a

closely monetarist view on the role of these policies in a stabilisation plan. The Three-Year plan apparently followed the classic view that the means of payments should grow at the same rate as the real output, so that the means of payments expansion that exceeded the real output growth would cause inflation. The PEM and the PAEG were also based on the idea that the means of payments should grow at the same rate as the real output, but they also recognised that it was necessary to deal with inevitable cost pressures in the short run[27]. Therefore, they followed a modified version of the monetarist classic stabilisation theory. This modified version was based on the hypothesis that there was a minimum level of inflation that could be achieved without constraining the real output growth and this inflation level would be reached if the means of payments grow at a rate equivalent to the accumulated growth rate of the autonomous costs and the possible growth of the real output[28] (SIMONSEN, 1974: 90-91).

However, the monetary and fiscal policies were the only point of similarity between all plans. In the case of the other policies, there were important differences. For instance, the *corrective inflation* measures recommended by the IMF were adopted by the Three-Year Plan and the PAEG. In the case of the PEM, the policy-makers found it too risky to adopt these measures. The plan just signalled a gradual removal of the exchange rate subsidies and the aim of reaching a *realistic* exchange rate. Moreover, the rise in certain repressed public tariffs was not put in practice. The absence of these measures became a source of conflict with the IMF.

A second point to mention is the role of the structural reforms (specially the Land Reform) as a stabilisation device in the context of the Three-Year Plan. The PAEG also recommended structural reforms, but the plan didn't identify them as a way of solving a structural inflation being demand-pull and cost-push inflation the only

[27] For instance, the need to recover wages purchasing power in the case of the PEM and the *corrective inflation* measures of the PAEG. According to Simonsen (1974), the Three-Year Plan also followed this modified version of the classic stabilisation theory. However, the plan's document does not show evidence of this idea. Moreover, this is not likely to have happened because the Three-Year Plan didn't recognise cost-push inflation as one of the causes of the Brazilian inflation.

28 The possible growth of the real output was fundamentally defined based on the observed real output growth of the preceding years.

inflationary sources that this plan identified. Therefore, the structural reforms were an idiosyncratic element of the Three-Year plan stabilisation policies.

A third and more important point of difference has to do with the wage policies. The PEM and the PAEG identified cost-push inflation and in this context the wage policy became a part of their stabilisation efforts. The PAEG's wage rule was a crucial element within the plan's stabilisation strategy and was an innovation in relation to the other plans (SIMONSEN, 1974: 83; SOLA, 1998: 200; 279). Although it was a regressive way of solving the conflicting claims problem, it proved decisive in the plan's results. In the case of the PEM, the policy-makers intention was also to adopt a conservative wage policy as a stabilisation measure. Nevertheless, the plan was implemented in a democratic context and the political conditions of that time made it impossible to adopt such a policy. Thus, there was no wage rule. In fact, the programme's basic guideline on this issue was simply not to provide real wage gains above inflation.

In this context, the Three-Year Plan didn´t identify cost-push pressures, so that the wage policy was not considered as a major cause of the Brazilian inflation. It may be mentioned that there are two factors that show that the policy-makers that implemented the plan didn´t ignore the importance of the cost-push inflation: 1) the document mention as a general guideline that the wages should grow in line with productivity; 2) the plan proposed wage increases below the inflation rate for 1963. Notwithstanding, these factors appeared discretely in the plan´s document and there was no proper wage policy in the plan.

In this respect, it is interesting to notice that the wage policy was basically the only difference between the PAEG and the Three-Year Plan in terms of the recommended short-term stabilisation policies. A close look to table 2 shows that both plans imposed credit and monetary controls, a fiscal adjustment effort, *corrective inflation* measures and the target of achieving a realistic exchange rate. The fact that the wage policy was the basic difference between both plans may give the impression that these two plans were fairly similar. However, this conclusion is misleading. The wage policy was crucial to the results obtained by both plans and was also relevant in terms of

their internal consistency. This point may get clearer through the equation developed by Simonsen (1974) and reviewed by Serrano (2010).

$$\mathbf{\Pi_t = a\Pi_{t-1} + b(y_t - y^*) + c_t} \quad (1)$$

Π_t = inflation rate at t

$a\Pi_{t-1}$ = inertia component[29]

$y_t = \Delta y/y$ = actual rate of real output growth at t

y^* = normal rate of real output growth

$b(y_t - y^*)$ = demand regulation component

c_t = autonomous component (cost shock)

The equation tries to depict the most important determinants of the inflation rate in a context of a chronic inflationary process as was the case of Brazil in the mid-Sixties. According to it, the inflation rate in a chronic inflation context can be explained by three components: 1) the *demand regulation* component; 2) the inertia component; 3) the autonomous component. The demand regulation side is based on the idea that there is a normal rate of output growth (y^*) under which there are no inflationary pressures. Whenever the economy grows at a rate faster than this normal rate, then there is a rise in the inflation rate. The inertia component provides the effects of the past inflation in the current inflation rate and is directly related to the capacity of different groups to sustain their purchasing power under a context of rising prices. Finally, the autonomous component is the cost-push component and is due to factors such as wage readjustments above the inflation, exchange rate shocks and agricultural price rises caused by bad harvests (SIMONSEN, 1974: 97). The equation shows that the higher is the value of the

[29] Simonsen (1974) named this component as *feedback* component.

inertia coefficient (a), the more it will be necessary to adopt conservative fiscal and monetary policies and to grow at a slower rate in order to reduce the inflation rates[30].

In the context of the Three-Year Plan, the conflicting claims were acute, so that it is reasonable to suppose that the inertia coefficient was higher than one ($a > 1$). The plan tried to reduce this component through a strategy of raising public wages below the inflation rate, but this proved unsuccessful because of the prevailing political coalition and the social unrest context. Given this failure, the cost shock due to the corrective inflation measures ($c_t > 0$) boomed the inflation rates what turned into a wage-price spiral that contributed strongly to the plan's collapse. The only way to stabilise prices within this context of a high inertia coefficient and a cost shock would be through a deep recession what was in sharp contrast with the aim of gradually stabilising prices.

In the case of the PAEG, the wage rule solved the conflicting claims problem through a regressive way. In this sense, the wage rule adopted in the plan reduced the inertia component ($\Delta a < 0$). This reduced inertia coefficient helped for instance to curtail the possible wage-price spiral effects of the cost shock caused by the corrective inflation policies ($c_t > 0$) (SIMONSEN, 1974: 107-108). Thus, the wage rule prevented the wage-price spiral effects and opened the space for a more gradual stabilisation effort. Therefore, the wage rule had a crucial role when one compares the Three-Year Plan and the PAEG.

In sum, the comparative analysis shows that there are more points of difference than similar points between the three gradualist plans. These plans were mainly heterogeneous efforts and didn´t share a common perception on the causes of inflation and on the necessary policies to stabilise prices. In this context, these heterogeneous aspects lead to the conclusion that it is not possible to define a gradualist stabilisation plan as a set of specific macroeconomic policies. In other words, given the Brazilian experience of gradualist stabilisation plans of the late 1950s and the first half of the 1960s it is not possible to define a general pattern of what a gradualist stabilisation plan might be.

[30] It is important to mention that a conservative wage policy is not the only way to reduce the inertia coefficient. There are other forms of incomes policies to do that like for instance price controls. In this sense, there were less regressive ways of reducing the inertia coefficient than the wage rule.

In this respect, it is however possible to underline some interesting points. The PEM and the PAEG were to a certain extent similar plans. In reality, the PEM may be seen as a pioneer to the PAEG since it was elaborated a couple of years before and they both had Roberto Campos as one of its main policy-makers (SOLA, 1998: 416). Both plans had for example the same diagnosis that the Brazilian inflation was due to demand-pull and cost-push factors. The differences in terms of the wage and exchange rate policies were strongly due to political factors. The PEM document stated that it was the policy-makers intention to adopt a more conservative wage policy. Moreover, the testimony of Lucas Lopes and Roberto Campos made it clear that there were no further exchange rate reforms because of the political costs of such a policy. As the PAEG was implemented during a dictatorship, these political constraints that the PEM faced were largely eliminated. Moreover, it is also worth mentioning that the PAEG was implemented in a period of much higher inflation, so that there was a need for tighter policies than in the case of the PEM.

In this context, the Three-Year Plan appears technically as an idiosyncratic gradualist stabilisation experience in comparison to the other two plans. The identification of a structural inflation and the recommendation of structural reforms and the continuity of the industrialisation process as a way of stabilising prices is in sharp contrast with the PEM and the PAEG. Furthermore, the Three-Year Plan was the only programme that didn't include cost-push factors as a source of inflation what resulted in the absence of a wage policy. These differences may be explained by the fact that the Three-Year Plan was implemented during the left-wing government of João Goulart, so that highly regressive wage policies were unthinkable and the need to advance reforms was a key issue. Furthermore, the plan was elaborated by an economist of structuralist background (Celso Furtado) that was not present in the team that elaborated the other two plans.

Notwithstanding, despite all the technical differences above mentioned, there is at least one important element that is common to all three gradualist plans. This last element is related to the reasons why the gradualist strategy was chosen instead of a *shock therapy*.

In all three plans, the gradualist option was a pragmatic attempt to deal with the internal and external constraints that the government was facing. On the one hand, it was necessary to adopt a stabilisation plan in order to get the approval of the IMF and thus obtain the needed external credit to face the balance of payments difficulties. On the other hand, it was not possible to adopt a typical IMF supported stabilisation plan because that would mean output losses that would not be accepted by the political and social actors. Therefore, in all three plans the gradualist stabilisation strategy was an effort to conciliate these internal and external constraints. If approved by the IMF, the gradualist plan would help the government to get the external funds without the need of adopting a deflationary shock[31].

However, the results obtained by the plans were quite different in this attempt of conciliating the internal and external constraints. The *Monetary Stabilisation Programme* and the *Three-Year Plan* were for instance unsuccessful and abandoned. More than that, they ended up dissatisfying most of the different social and political actors. In the case of the PEM, the IMF Board was reluctant to approve the gradualist plan. Furthermore, there was strong internal resistance to the programme since the industrialists, the coffee producers and the PSD-PTB political coalition opposed most of its policies. As a result, the government finally gave up the efforts of conciliation, abandoned the plan and broke up with the IMF. As it was pointed out by Sola (1998), the JK government perceived as more strategic to regain control of the internal coalition and to finish the projects from the Targets Plan (SOLA, 1998: 223).

The *Three-Year Plan* was implemented in an even more complex situation since the difficulties in the balance of payments were larger and the inflation rates were also at a much higher level than in the case of the PEM. In political terms, the fact that the president belonged to the Brazilian Labour Party (PTB) meant that there were rather great expectations from the trade unions of real wage gains, what restricted the degrees of freedom in relation to the wage policy. Moreover, the IMF kept reluctant to accept a

[31] In the case of the *Three-Year Plan,* there was a technical reason related to adopt a gradualist strategy, which was related to the plan's interpretation on the causes of the Brazilian inflation. If the Brazilian inflation was partly due to structural factors, then orthodox short-term stabilisation policies would be unable to entirely solve the problem. In other words, strict orthodox short-term policies were not recommended because they would cause output losses without actually solving the inflationary problem (FONSECA, 2004: 607-608).

gradualist stabilisation plan and the United States government had serious doubts on Goulart's intentions, so that just a very modest financial aid was offered. The lack of external support and the plan's technical problems – due to this effort of conciliating different demands – ended up in the abandonment of the stabilisation efforts and finally in the 1964 *coup d'état.*

The only plan that managed to overcome the external and internal constraints was the PAEG. This success was however a consequence of a much less constrained political scenario. In the external front, the IMF was much more flexible and approved the gradualist plan. Furthermore, the United States administration supported the Brazilian government and thus gave substantial financial aid. In the internal scenario, the programme was implemented in a dictatorship, so that the Castello Branco administration could more easily define who was going to pay the costs of stabilisation. In this sense, the workers were the main losers of the stabilisation process, what resulted in a significant real wage fall in the first years of the military regime.

In this context, it is curious that the most successful of the three gradualist plans was precisely the one that was implemented in the worst economic situation. At the time of the PAEG implementation, the inflation rates were higher than in the other programmes. At first, it may seem that this result was just a consequence of PAEG's merits, but this conclusion may be at least partly misleading. On the one hand, the PAEG was implemented in the less favourable economic context, but on the other hand the plan was implemented in the most favourable political context. The combination of these two aspects – huge economic crisis and a less constrained political scenario - gives support to the idea developed by Sola (1998) that at that time the Brazilian inflation was mainly a political problem. During the implementation of the PEM and the Three-Year Plan, there were many political constraints and nobody wanted to pay the stabilisation costs, so that it was extremely hard to implement a stabilisation programme. In this sense, Sola (1998) came to the conclusion that it became impossible to democratically manage the inflation at the end of the 1950s and beginning of the 1960s (SOLA, 1998: 203; 367; 410).

The dictatorship implemented after 1964 was able to do it because on the one hand it had the advantage of negotiating with a more flexible IMF and received foreign

financial help to attenuate the external constraint problem and on the other hand it solved the conflicting claims problems with a regressive solution. Given the reduced internal and external constraints that the PAEG faced, it became politically possible to implement a relatively successful stabilisation programme.

Conclusions:

The article presented and analysed the Brazilian gradualist stabilisation plans of the late Fifties and beginning of the Sixties in order to discuss whether or not it was possible to identify a pattern between them. For this purpose, the main macroeconomic policies that these plans recommended and the programmes diagnoses in terms of the inflation causes were taken into account. It was shown that there were important differences in relation to the inflation diagnoses, the wage policy, the exchange rate policy and the adoption or not of the so called *corrective inflation* measures. The only point in common was the monetary and fiscal policies since all plans identified demand-pull inflation and followed a monetarist view in relation to this matter. In this sense, it was concluded that it was not possible to identify a pattern in these gradualist programmes since there were more differences than similarities between them. In this respect, the Three-Year Plan was identified as being particularly different when compared to the other two plans.

However, it was also shown that all three plans adopted a gradualist strategy because of political reasons. The gradualist option was a pragmatic attempt to deal with the internal and external constraints that the government was facing. The government needed to get its stabilisation plan approved by the IMF to get external credit, but was unable to adopt a typical IMF supported stabilisation plan since such a plan would cause deflationary effects that would not be tolerated by the political and social actors. The gradualist stabilisation plan emerged then as a second best. If approved by the Fund, the plan would allow the government to get the external credit without having to cause a recession.

Nevertheless, this conciliation strategy failed in the case of the PEM and the Three-Year Plan because both plans ended up dissatisfying most of the actors. The PAEG was the only gradualist plan that was relatively successful because it was

implemented in a dictatorship and had the US government support. In this respect, the fact that the plan that faced the less constrained political scenario got the best economic results showed that the Brazilian inflation of the late of Fifties and beginning of the Sixties was to a large extent a political problem.

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