CONFIDENTIAL

CONTENTS

I. The Brazil of 1972 -- Objectives

The pattern of development must be cut to fit Brazil's needs.

Population:

1966 -- 85 million	
1972 -- 101 million	

Labor Force:

1966 -- 30 million	
1972 -- 36 million	

Brazil's minimum goal must be to provide 6 million new jobs to keep unemployment constant. If possible, it should provide more -- to reduce the unemployment.

Urbanization:

1966 -- 43 million -- 50%	
1972 -- 60 million -- 60%	

Brazil must provide minimum urban services -- housing, water, sewerage, transportation -- for 17 million new city dwellers, not to mention the millions presently without such services. For example, only 40 percent of city dwellers have clean water supplies -- the Charter of Punta del Este declares 70 percent as a minimum objective.

Housing:	1966 -- 21 million families 14 million "adequately" housed
	1972 -- 25 million families 18 million "adequately" housed

Brazil will require over 600,000 new units annually just to stay even, not to mention the backlog estimated at 6 to 8 million.

School children:	1966 -- 19 million school age children -- (7 to 14 years old) only 50% in school
	1972 -- 24 million school age children -- 80% in school

To stay even, Brazil must provide teachers and schools for 5 million children. Even a minimum goal of 80 percent by 1972 will require a doubling of enrollment -- from 9 to 18 million. Of 100 children entering grade 1, 20 finish primary school, 3 finish secondary school and only 1 graduates from a university. The Charter of Punta del Este has an objective of 6 years of primary schooling for all children.

Food Supply - Nutrition:

-- Annual increases of at least 6 percent are required to supply the growing population, to improve nutrition, to accelerate diversification (particularly away from coffee) and to expand exports.

-- Of every 20 children born, only 10 live beyond 6 years of age and 7 of these children are undernourished.

Power:

1966 - 9.2 million kw
1972 -- 18.3 million kw

Fortunately, Brazil has ample hydroelectric potential, but large new investments needed to meet demands.

Regional Disparities:

1966 --	Northeast	São Paulo Guanabara Minas Gerais	Other
	30 % of population	37% of population	33% of population
	15% of income	55% of income	30% of income

1972 --

Unless special efforts are taken, the concentration of income, industry, and population in a few relatively wealthy states will continue and the north-south disparities will grow.

What will it cost?

The costs of meeting even modest social goals are staggering. These examples will suffice:

Jobs: At least 1 million additional jbbs are needed each year for unemployment to remain constant. Even this will require an investment of $34 billion in the years 1967-1972, an increase of 70 percent in current investment levels.

Housing: Constructing 600,000 units annually would cost $2.1 billion at $3,500 a unit. Such an investment would represent almost 8 percent of GNP, or one-half of net investment.

Water: To provide minimum water requirements for the current and new urban dwellers, at least 28 million people need new service costing $____ billion.

Schools: To provide only classrooms for the 9 million additional children so at least 80 percent of the 7-14 year olds can be given basic education would cost $750 million.

Brazil's GNP should grow by 8 percent annually.

Brazil's GNP is now around $20 billion. Gross investment is about $4 billion. With a projected growth rate of 6 percent, unemployment, slums and illiteracy will continue to grow. Growth rates of 10 percent for a number of years are probably necessary to meet adequately the backlog of needs or the expectations of the people. If Brazil is to progress toward self-sufficiency and make some creditable progress toward meeting the social goals of the Charter of Punta del Este, it should establish the maximum feasible growth targets. We believe that by 1972 Brazil should aim for a growth rate of 8 percent, a GNP of $30 billion and gross investment of $7 billion (23 percent of GNP).

Is an 8 percent growth rate feasible?

Brazil has achieved it before, but it will require a gargantuan effort involving:

-- an increase from about 17 to 18 percent to 23 percent in gross investment as a percentage of GNP. This will mean a substantial increase in domestic savings.

-- greatly improved public administration, and particularly in project preparation and execution.

-- growing availabilities of skilled manpower.

-- substantially more liberal trade and foreign investment policies, with greatly expanded imports and exports. Brazil must seek and permit the real transfer of resources it needs to achieve expanded growth levels.

The GOB long-range plan for 1967-1971 is only in rudimentary form. Not until the end of 1966 can we expectthe basic policy decisions and objectives to be established. Thus the goals indicated here are those which the U.S. should urge the GOB to establish and be prepared to assist in achieving. As the plan frame becomes clearer and the sector allocations determined, the specific U.S. objectives, program and funding will necessarily be revised.

II. The AID Strategy

AID will ~~also~~ focus on key bottlenecks and problems which inhibit a high rate of growth. These fall into 4 categories.

First, Capital Accumulation

AID will itensify efforts in tax administration, financial systems, development banks, capital markets, rural credit institutions, savings and loan associations, co-ops, investment promotion, foreign investment guaranties, etc., which affect voluntary and involuntary savings.

Second, The planning and management of investment programs

AID will concentrate on development planning; feasibility and sector studies; statistics; government investment operations in highways, water and sewerage, housing, ports, telecommunications; municipal administration.

Third, Manpower

AID will assist in expanding the supply of skilled manpower and in breaking critical bottlenecks. Targets include secondary school expansion with greater emphasis on non-academic curricula, adult vocational training, university modernization, adult literacy and textbooks. Agronomists, economists, business administrators and engineers are special skill targets.

Fourth, Agriculture

The lagging rural sector retards overall growth rates, skews investment toward capital-intensive fields, accelerates the flight to the cities and retards development of a national domestic market. Brazil will fail to meet growth, employment and social objectives without an agricultural revolution. AID will concentrate on marketing, credit, co-ops, fertilizer production and distribution, pricing policies, feeder roads, storage.

Special attention has been given to the rate of growth in the Northeast and other "Brazil B" areas. Without special effort of building the development base, identifying underdeveloped resources and capital investment opportunities, growth in these areas will be less than those in the market economy of south-central Brazil. Although priority will be given to the four problems cited above, important programs will be continued in health, industry, housing, labor and public safety.

III. Political Caveat

In looking ahead to 1972, we have assumed political stability, political institutions and performance compatible with U.S. objectives, and a government dedicated to development and reform. We have also assumed a reasonable degree of price stability by the beginning of FY 1968.

Frankly, these assumptions are subject to serious doubt. First, there is mounting dissatisfaction with the government's economic program among all classes of the society. Recent price rises have been unexpectedly high -- 14 percent in the first quarter of 1966. Labor's real wages have fallen. Business confidence in the stabilization program has been shaken and investment has not increased as anticipated. Overtones of strident nationalism and anti-Americanism are growing.

Second, the government has gradually assumed arbitrary political powers, partially as a result of economic discontent. Existing political parties have been abolished, the government's authority to curtail political rights has been extended, and election of president and governors has been changed from direct to indirect. These extraordinary powers virtually guarantee election of a revolutionary president acceptable to the Castello Branco government despite the unpopularity of its policies and lack of a broad political base.

Until there is significant improvement in the economic situation, the next president will be under heavy pressure to alter the present economic policies. Moreover, the unpopularity of these policies and the limited political base may lead the revolutionary government to take further arbitrary political steps and further delay the timetable for return to constitutional democracy. The situation is complicated by the distinct possibility that the next congress scheduled for direct elections in December, will be dominated by the opposition and far less likely to support rational economic policies.

On balance, there is reason for guarded optimism. Costa e Silva, the likely next president, appears to have the personal determination and the support of the military needed to give continuity to present economic policies. If the economic situation improves in the next year, as we believe it will, the government's policy will become a political asset and contribute to a broader popular base. This in turn will increase the chances of moderate political policies and the return to Constitutional democracy.

IV. Estimated AID Levels

The projected FY 1968-1972 aid levels by category to meet U.S. objectives are as follows:

	1968	1969	1970	1971	1972	1969/ 1972	1968/ 1972	Per-cent Dist.
	(millions of dollars)							
Total All Goals								
DG	18.6	19.1	17.6	15.4	12.2	64.6	82.9	3.8
DL (project)	175.0	250.0	200.0	150.0	150.0	750.0	925.0	42.8
(program)	125.0	100.0	100.0	100.0	50.0	350.0	475.0	22.0
PL 480, Title II	33.3	35.2	40.1	41.5	46.7	163.5	196.8	9.1
III	19.3	17.5	15.8	13.1	8.7	55.1	74.4	[illegible]
IV	59.0	64.0	68.0	73.0	78.0	283.0	342.0	[illegible]
MAP	13.5	14.3	13.3	13.2	13.3	54.1	67.6	3.1
Total	443.7	500.1	454.8	406.2	358.9	1720.3	2163.7	100.0

Note: Significantly higher Brazilian efforts to meet more adequately 1972 targets also calls for higher and more sustained levels of external assistance. These were foreseen in the FY 1967 CAP where lower levels of growth, social objectives and political viability were assumed.

Aid requirements were derived from the USAID objectives and activities (noted by goals below) and were based on the following assumptions of Brazil's economic development needs and external assistance:

-- Brazil's growth rate rising from 6 percent in 1967 to 8 percent in 1971 and 1972.

-- Gross investment rising from the present level of 17 to 18 percent to 23 percent of GNP by 1972.

-- The savings-investment gap which must be filled with external resources averages 2 percent of GNP over the period.

CONFIDENTIAL

-- Import policies sufficiently liberalized to allow needed external capital and intermediate goods to flow into Brazil. Import coefficient to investment was approximately one-third at the start of the period. By 1972 imports will be expanding less rapidly than GNP with rates of increase converging.

-- Vigorous export expansion equivalent to growth in GNP.

-- Increasing amounts of new foreign private investments.

-- Expanded levels of lending activity by the IBRD, IDB, Ex-Im Bank and other developed countries (see Annex II).

The balance of payments gap, based on these levels of growth and investment requirements (see Annex ___) and new foreign aid flow needed to fill this gap is foreseen as follows:

CONFIDENTIAL

GROWTH RATE, BALANCE OF PAYMENTS AND GAP PROJECTIONS

	1967	1968	1969	1970	1971	1972
			(percentage)			
Rate of Economic Growth	6	6.5	7	7.5	8	8
			(millions of dollars)			
Current Account	-330	-390	-430	-515	-580	-650
Exports	1800	1920	2060	2200	2380	2570
Imports	-1620	-1770	-1970	-2170	-2390	-2620
Invisibles (net)	-510	-520	-520	-545	-570	-600
Capital Account (net)	36	112	134	111	68	81
Balance of Payments Gap	-367	-341	-356	-471	-585	-646
New Foreign Aid Flow	179	213	288	411	546	536
Others (net) 1/	-	26	91	161	235	288
USAID						
Program loans	125	125	100	100	100	50
Project loans	-	9	34	92	151	138
PL 480	54	53	58	58	60	60
USAID Total	179	187	197	250	311	248
Unfilled	-188	-128	- 68	- 60	- 39	-110

1/ IDB, IBRD, Ex-Im Bank, Europeans (see Annex II).

It will be noted that:

-- the rising balance of payments gap is increasingly filled by the disbursement flow from international lending agencies' loan authorizations.

-- there is great need for U.S. program loans in 1967 and 1968, while the disbursement flow from new project loans is building up.

-- the AID proportion of gap financing is reduced by 1972 from over 50 percent to less than 40 percent.

CONFIDENTIAL

V. Types of Aid

A. Development Loans

Brazil has a well-developed industrial structure which even currently can produce most of its investment requirements, such as turbines, generators, motors, road equipment, ships, steel, etc.

As a result, only a small portion of Brazil's investment is in the form of discrete projects with a large, direct foreign exchange component. Much of it is additions to current capacities. Moreover, other lending agencies have first opportunity to finance such projects. Therefore, AID must be prepared to finance essential non-projectized import requirements and a high proportion of project local currency costs.

These local currency costs will indirectly be converted into foreign exchange requirements. Based on a current survey of historical data, the import coefficient of new investment is at least 30 percent for components and industrial raw materials. Rising foreign exchange availabilities are essential if Brazil is to achieve a high rate of growth.

To the extent practicable, we have included local currency financing in the project loan figures. Such financing will include cruzeiro costs of discrete projects with a direct foreign exchange component. They also include projects without an appreciable foreign exchange component such as savings and loan associations, educational construction, agricultural co-ops and feeder roads. Unless we have the flexibility to make such loans, we do not believe it will be possible to fulfill the social agenda recently stressed by President Johnson.

CONFIDENTIAL

The local currency requirements which do not lend themselves to the project approach will be met through the program loans. Program loans have real advantages.

First, they enable the U.S. to influence policy and resource applications, both at the national and the sector levels. The experience of the 1965 and 1966 program loans has already proven the value of this approach.

Secondly, they concentrate the Mission's staff on broad questions of priorities and policies rather than on the minutia of individual projects. As the lender of last resort, AID will only be able to finance the least strategic projects in Brazil if it insists on financing only projects with a high direct foreign exchange component; it is wasteful to concentrate high level mission manpower on the development and execution of such projects.

B. PL 480 (V)

PL 480 Title I is projected to increase 3 percent annually, or roughly at the rate of population increase. Titles II and III will show modest increases consistent with the administrative capability of the ministries involved and the USAID.

C. Development Grants are expected to reach a peak in 1968 and 1969. By that time it is expected that the most critical institutional deficiencies will have been identified and that effective remedial action will have been started. Beginning in 1970 the program is expected to taper off, as shown in the table.

CONFIDENTIAL