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AID/Washington

SUBJECT - FY 1969 Program Submissions - Major Issues

CA-5426, January 21, 1967

AIDTO Circ. XA 2031, February 28, 1967

AIDTO Circ. LA 135, March 1, 1967

JOINT AID/STATE MESSAGE FOR AMBASSADOR AND AID MISSION DIRECTOR

This message supplements world and region-wide guidance already provided in referenced circular airgrams. It should assist the USAID and Country Team in the drafting of the Economic/Social sections of the Country Analysis and Strategy Paper (CASP) and of the more detailed aggregate and sector strategies in the AID Program Memorandum.

The 1966 Program Memorandum for Brazil met a very favorable reception in Washington. Its broad analytical framework for U.S. assistance strategy forms the basis for our FY 1968 Program submission to the Congress, and has provided a sound justification for continued allocation of a large proportion of total Alliance funds to Brazil. Nonetheless, a number of unresolved issues arose during the fall program review and during discussions of the proposed FY 1967 Program Loan. These issues, together with questions stimulated by the change of administrations in Brazil, and by a greater need in Washington for comprehensive sector strategies, should condition this year's submissions.

Brazil's long-range development planning efforts have moved substantially forward in the past twelve months. A new government will soon be taking office with perhaps somewhat different development priorities and attitudes toward U.S. assistance. The USAID now has the benefit of several research studies which should help illuminate issues that were poorly understood in early 1966. and it can also better test certain Program Memorandum assumptions against

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Brazilian institutional capabilities. Also we have found from a year's experience with the Program Memorandum that analysis can best take place through asking at both the aggregate and sector levels what are the principal changes or reforms desired in the Brazilian economy, institutions and public policy and how can we best use aid both as leverage to get these reforms and to transfer real resources to help implement them. For these reasons, AID/W looks forward to an even higher standard of analysis in the 1967 program submissions from Brazil.

Listed below are some of the issues concerning our development assistance strategy for Brazil which are likely to arise during Washington or field program reviews this year. We welcome informal, frank exchanges with the Mission on these or other questions during the coming weeks to insure the best possible preparation for the Washington IRG reviews of the CASP and the field review of the draft Program Memorandum scheduled for August.

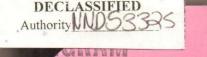
A. General Policy Issues and Macroeconomic Strategy

- 1. To what extent are GOB objectives and intentions consistent with the development goals stated in the 1966 Program Memorandum? To what extent are we describing only U.S. hopes for Brazil and to what extent are they Brazilian goals which the new government will actually pursue? The answer to this should more clearly reveal the degree of change to be sought and the leverage necessary to bring this change about. Two particular points require treatment.
 - a) The nature and likely influence of government planning(macro, regional, or Sectoral) over the next four years. Is Brazil likely to swing back toward more decentralized decision-making by various government agencies on economic policy issues? If so, what changes are necessary in our analytical approach, or in our assistance program? (e.g., Univ. Calif. contract)

At the present stage of national planning in Brazil, what is the Mission's judgment as to the overall viability of the resource allocations projected? Are they politically feasible, and economically sound? the political

What are the likely parameters of U.S. influence in bringing about the changes identified under (1)? Can the extensive U.S. influence on GOB decision-making, particularly in sensitive domestic areas such as national, development planning, monetary policy, tax administration, education reform, etc. be sustained during the next administration? Will the political climate require alteration or abandonment of the program loan negotiating procedure developed so successfully with the Gastello Branco Government? How can broad self-help commitments best be elicited under Costa e Silva? How could putting all lending on a project or sector basis within two-three years affect U.S. leverage? (Note that to date we have been singularly unsuccessful in exerting leverage on this basis in other Latin American countries).

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Does the total impact of U.S. assistance programs in Brazil tend largely to bolster. The status quo; identify the U.S. with modernizing trends in Brazilian society, both economic and political; or have neither effect in any clear way? Are Alliance for Progress programs affecting the internal power structure in Brazil to any appreciable extent? (possible examples: political effects of coffee diversification program if any; lagging agrarian reform efforts of GOB; education reform efforts and their effects on politically active students, etc.) Do U.S. programs have any discernible effect toward reducing regional disparities, or twards increasing popular participation in the development process?

- 3. Macroeconomic issues within the 1966 Program Memorandum model:
 - Are there any changes in the employment assumptions of the Program Memorandum?
 What are the most recent data on employment trends, growth of labor force
 (rural and urban), and best current estimates for investment/job ratios in both urban and rural sectors?
 - b.) What are the real development effects of the proposed degree of import liberalization? Is the resource transfer of investment goods now taking place more effective than previously? What are current import coefficients for new investment in selected areas? Are the import projections in the 1966 PM still valid? What further liberalization measures are needed? What implications should be drawn from the Clark study? Is the level of projected foreign exchange reserves reasonable? Does Brazil's foreign exchange position suggest a lesser requirement for balance of payments support and a consequent shift in 1968, 1969, and beyond to sector and project loans?
 - what are the best current estimates of payments flows from exports, other lenders, and from private foreign investment? For planning purposes, who was a ssume what we process will remain at present levels.
 - d.) How can the actual allocation of U.S. assistance be shifted more rapidly to reflect the sectoral priorities described in the 1966 Program Memorandum?

The major share of U.S. resources from project lending continues to go into power, industry and transportation. While appreciating the importance of road construction/maintenance and agro-industrial development to agriculture, how can a more rapid shift away from other types of infrastructure lending be achieved? In considering this question the Mission should discuss factors which may now limit the transfer of U.S. resources to priority sectors such as agriculture and education, e.g., restrictions on local cost financing, concern for U.S. export promotion, institutional weaknesses, etc. We expect the Mission throughout the Program Memorandum to present what it considers to be the optimum development strategy, clearly pointing out the costs to this strategy should other policy choices, e.g., reduced local cost financing, be selected. In the selection of projects for U.S. financing consideration should be given to the xxxxx relative cost of procurement from the U.S. and from other sources.

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- e) :To what degree can domestic investment targets of the FM plus some degree of wage liberalization be made campatible with price stabilization objectives? What policy changes are needed to simulate private investment and/or finance larger public investment to achieve the goals of the FM? Can the monetary stability assumption be reconciled with these goals? How would the growth model, savings/investment ratio, etc., be modified with different assumptions about the rate of inflation throughout the planning period? What quantifiable degree of wage policy "humanization" might be accommodated to the stabilization goals? If some change in wage policy occurs, would it better be confined to specific worker groups, e.g., minimum wage earners; for optimum economic and social effects?
- What kind of revenue performance can be expected from the Brazilian tax system?

 What are the likely effects of recent changes in tax policy and administration on revenues, on income distribution; and on allocations of resources to federal, state, and local governments? When all levels of government are considered, the ratio of Brazil's public revenues to GNP is by far the highest in Latin America. (Is GNP undervalued?) This level implies that the primary problem is keeping expenditure under control and making sure that its composition covers the country's development needs and Alliance commitments. Can you make a detailed analysis of expenditure patterns, perhaps as a Special Study? Your analysis should identify also needs for further improvement in the planning and budgetary control systems.

The remainder of the public finance problem centers around the quality of the tax system, its elasticity in the face of inflation, its effects of private saving and investment incentives, and its effect on income distribution. What is the current situation in these respects, and likely Brazilian policies? What additional institutional strengthening should we propose?

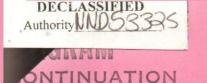
g) What are best estimates for capital/output ratios in various sectors or industrial sub-sectors?

4. Alternative model:

At least one alternative development strategy for Brazil should be outlined and seriously analysed in brief form with arguments for and against it. It may take into account the following points:

- a) Is an 8% annual GNP growth target or a 21% savings ratio target by 1971 really possible for Brazil on a sustained basis? Is there, for example, a lower growth rate, higher labor-intensive investment plan possible which might better meet the overall employment targets at more attainable savings and investment levels. If so, how would the U.S. design assistance to support such a strategy?
- b) Or, for another example, could a plausible development strategy utilize a relatively high continuing rate of inflation to effect forced savings and income transfers needed for higher investment rates? (i.e.,20%-30% range). Analyze whether/finflations of these magnitudes can be prevented from "taking/exertixeextinuing off".

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c) Can savings and foreign investment really increase at an adequately rate to allow an 8% growth rate and a politically tolerable increase in **EMEXAMP* consumption?

From 1939 to 1960 national income in Brazil grew by about 229% with the ratio of savings to gross domestic product remaining relatively constant. Leff indicates that this was largely based on heavy foreign investment and short-term supplier credits and resulted in a redistribution mx of income such as to substantially increase consumption. With the development of such consumption patterns (and the resulting political consequences likely from continuing austerity at the level of 1966) plus the increasing defensiveness in key sectors of Brazilian industry in the face of outside penetration, how can the pattern of growth be reoriented to provide for a greater degree of savings but also permitting a consumption level which is politically tolerable? While such a pattern does require, we think, a substantial inflow of private foreign capital what policies would maximize the inflow that is politically tolerable to the Brazilian business community and the new government? What would be the implications for the stabilization program of policies which would permit such growth?

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Given the above analysis, what alternatives to the Program Memorandum model are most likely?

Sector Issues

The sector discussions should to the extent possible present a comprehensive strategy for agriculture, and education, and a general plan of action for public administration. They should proceed from the question of reforms or changes needed and proceed to the A.I.D. leverage to bring such changes about. They should state wherever possible how far Brazilian society has moved during the last 12 months toward the quantified targets in last year's Program Memorandum.

- 1. Agriculture: The agriculture sector paper should provide a comprehensive strategy to integrate the total U.S. program in the sector. For example, changes in credit policy and total credit requirements should be so stated to permit comprehensive axidyx analysis of counterpart requirements for this purpose from the Program Loan, the Sector Loan, and the P.L. 480 agreement. Some important questions are:
 - a) Will the presently planned coffee diversification incentives be sufficient to bring supply intox balance or will additional policy changes be required?
 - Is there real economic justification for the GOB's channeling more credit to the agricultural sector for export promotion or for employment creation? If so, how much more? Should credit be concentrated in a few regions where it promises greatest returns?
 - What have been the real effects of pricing policy changes in non-coffee agriculture on real return to the farmer, and what additional changes, if any, should the U.S. seek?

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 - d) What is the present state of improving the operations of the Ministry of Agriculture, of clarifying responsibilities and simplifying procedures? How may AID best further a more rational coordination of the numerous extension, research,



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credit and other agricultural institutions?

- e) Is the sector loan technique still regarded as the most effective way to produce sufficient self-help commitments in agriculture even when such changes depend on several ill-coordinated GOB institutions?
 - What are the prospects for the "GERAN PIAN" for modernization of the Northeast Sugar zone? Is there a solid GOB commitment to implement this program? What should be the U.S. role, if any? If GERAN concentrates primarily on the economic problem of sugar, rather than the human resource-unemployment problem, is it in U.S. interests to be identified with the organization? Can we exercise effective leverage with GERAN to avoid this undesirable result?
- g) The present education system cannot meet the manpower requirement for the anticipated expansion of the agriculture sector during the next five years. What is the extent of GOB recognition for the needs of such change and how may the U.S., within A.I.D. manpower constraints, most effectively contribute to such change?
- 2. Education: As in agriculture a total sector strategy should be developed which will serve as the basis for all reforms sought in the program and sector loans. The U.S. educational planning advisory teams now in Brazil should be able to contribute substantially to this strategy. It should state clearly what sorts of broad self-help objectives the U.S. should seek in any education sector loan negotiation. Key questions to answer, however, are:
 -) What are the realistic limits on U.S. influence in this politically sensitive field? Have we already exceeded them?
 - b) Is a broad sector loan with substantial self-help commitments likely to be politically more or less sensitive than other forms of assistance? Even if more, does the increase in leverage for reform over that to be obtained from less vulnerable project loans perhaps justify the political cost?
 - c) After one year's experience, what are the specific results of the work of the elementary and secondary educational planning teams? What specific areas of study are to be undertaken by these along with the higher education team over the next year? How are their conclusions now to be implemented? To what extent are the program targets described in last year's FM altered as a result of the planning teams' evaluation?
- 3. Development xx Planning and Administration: A general plan for GOB reform and U.S. strategy should be presented in this field to the extent possible. How best can we assure vigorous implementation of the constructive measures recently enacted in Administrative Reform and what other reforms or changes, if any, should we stress?
 - a) Can or should we do anything more to stimulate integration of SUDENE and other regional planning organs into the national planning effort?
 - can more be done to strengthen local and state governments, capacity to respond to local needs without abandoning on-going USAID programs aimed primarily at assisting national ministries? What are the priority problems for U.S. assistance



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C. Other Issues



What should be the future priority for U.S. assistance in the Northeast? Should the U.S. continue to demonstrate a "special interest" in this region? If so, with what level and kinds of resources? With what regional development strategy? Should any other regions receive special U.S. attention?



Do present projections for a phasing down of Public Safety programs accurately reflect the country Team's assessment of the potential insurgency threat and Brazilian police capabilities -- taking particular note of likely sharp reductions in MAP?



Title IX: We appreciate the thoughtful Mission reply (TOAID A-1288) to recent circular airgrams on the promotion and utilization of democratic institutions for development. It contains highly useful descriptions of on-going USAID projects which have a Title IX dimension. What additional can be done to influence the GOB toward greater reliance on local initiatives to help meet national development goals? Can the principles of the National Water Fund be extended to a Municipal Improvement Fund on a broader scale? How? Could projects like that for building rural feeder roads in Rio Grande do Sul serve as vehicles to involve municipal organizations more directly in rural development efforts? Could the CNEG community secondary school program utilize more assistance than it now receives? What more can AID do to assist IBAM, the Bahia Institute of Public Administration or other organizations to strengthen municipal and state governmental institutions? Should some of the current priority emphasis given to assisting federal ministries be re-directed to a few selected states where the pre-conditions for strong local government or development planning on the state level already exists? We agree that Title IX objectives should be met to the extent possible without increases in number of U.S. technicians, by means of careful program design at the national level. What role can increase Peace Corps/ AID collaboration play in this Title IX effort?



To what extent can Peace Corps and AID increase their complementarity and collaboration in the fields of agriculture, health and education?

5. Statistics:

In A-796 of November 7, 1966 the Mission stated that "Brazil is facing a statistical crisis which is hampering its development and **Redritive** stabilization efforts and makes planning and decision-making a precarious adventure." The above questions in the airgram may serve to further point out the need for statistical improvement.

a) Does the GOB adequately appreciate the need for improved statistics? Is full advantage being taken of the U.S. Bureau of Census, FAO, and IASI training and consulting capabilities.

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- b) How soon can we reasonably expect reliable and timely data on the national accounts, on the labor force and on unemployment? What progress is being made to improve statistics in such fields as agriculture, domestic commerce, industry, demography, etc. and what is/should be offered by outside donors?
- 6. Project and Sector Lending: In relation to the development loans proposed, the P.M. should summarize for both sector and project lending, the contingencies involved and the general target dates for authorization.

The purpose of the Program Memorandum is to summarize program recommendations concentrating on the principal issues and choices we face in FY 1968 and FY 1969. Treatment of many of the issues listed above should appear in one form or another in the CASP and the draft Program Memorandum; others are merely suggestive as to kinds of analysis whose results would strengthen this year's Program Submission from Brazil if they can be undertaken. Some questions probably cannot be answered, and a frank recognition of that fact is useful. The Mission can pose a greaterex many more issues, for those listed here merely illustrate the kinds of problems raised by an assistance program this large and complex. To the extent that they can be addressed in the draft P.M., however, AID/W will be better equipped to review constructively the Brazil submissions.

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