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NO.

TO : DEPARTMENT OF STATE

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DATE: June 17, 1966

SUBJECT : WEEKA 23

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MILITARY

Negative

ALLIANCE FOR PROGRESS

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12. Use of Foreign Engineers in AID-Financed Contracts Attacked

PSYCHOLOGICAL

Negative

GROUP 3: Downgraded at 12-year intervals; not automatically declassified.

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POLITICAL1. Opposition to Abstain from Indirect Elections

At a June 15 meeting of the MDB National Executive Office in Brasília, it was decided to recommend that the party abstain from participation in the indirect presidential and gubernatorial elections this year. The decision was adopted following an overwhelming vote in this sense by the presidents of the MDB state directorates who attended the meeting. The abstention recommendation will now be presented for final decision to the MDB National Convention, scheduled to meet in Rio on August 6.

In its note justifying the abstention position, the Executive Office declared it would continue to fight for a return to full constitutionality. The note also stated that the MDB would demand guarantees from the Government of freedom to carry out electoral campaigns in connection with the direct elections in November, including access to TV, radio and the press. (UNCLASSIFIED)

COMMENT: For the moment it would appear that the abstention school in the MDB has won out over the faction which argued that even a token participation in the indirect elections would be a more effective way to pressure the coming administration into a return to constitutional normalcy. (UNCLASSIFIED)

2. Minister of Interior Resigns

Marshal Cordeiro de Farias has resigned as Minister of the Interior and will be succeeded by João Gonçalves de Souza who had been Superintendent of SUDENE (agency for the development of the Northeast). In his letter of appreciation to Cordeiro, President Castello Branco referred to Cordeiro's differences with the administration over political policy, and in his departure speech at the Ministry on June 17, Cordeiro is expected to express disappointment in the outcome of the revolution and criticize the forthcoming indirect elections. (UNCLAS)

COMMENT: Although cast in ethical terms, Cordeiro's resignation is undoubtedly more a question of disappointment over not having been given a worthwhile shot at the ARENA presidential nomination. The choice of Gonçalves is considered favorable all around. (LIMITED OFFICIAL USE)

3. Juscelino Kubitschek Departs

After a nine-day stay in Brazil to attend the funeral of his sister (WEEKA 22), ex-President Juscelino Kubitschek departed Rio for New York on June 12. Friends of Kubitschek had reportedly approached

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the GOB to obtain assurances that he would not be harassed if he remained, but without success. (UNCLASSIFIED)

COMMENT: While Kubitschek's plight received considerable sympathetic press treatment, his visit does not appear to have had any political repercussions such as those at the time of his last visit in October, 1965. (LIMITED OFFICIAL USE)

4. Guaira Falls - Foreign Ministers to Meet

On June 10 the Foreign Ministry announced that Foreign Minister Juracy Magalhães would meet with GOP Foreign Minister Sapena Pastor June 21 and 22 at Foz do Iguaçu and at Puerto Presidente Stroessner for the purpose of examining the present status of Brazilian-Paraguayan relations and to try and reach a solution to the Guaira Falls dispute. (UNCLASSIFIED)

COMMENT: Juracy told the Embassy's Chargé that he is optimistic that a settlement will come out of the meeting, and subsequently made a similar statement to the press. He confided to the Chargé that he intends to propose at the meeting a plan whereby (1) the frontier issue would not be discussed, (2) troops of both countries would be required to remain at a specified distance from the frontier, and (3) an offer would be made to the GOP of condominium rights in the use of the power from all seven falls in the Guaira area. (CONFIDENTIAL)

5. Detained Americans

The trial of the four Americans charged with smuggling entered its last stage June 15, when the defendants' lawyers filed written summary arguments with the court. The Judge is expected to hand down his verdict on June 20 or shortly thereafter.

On June 12, apparently in a move to coincide with the concluding stage in the trial, the Estado de São Paulo began publishing in serial form a pamphlet issued by the DFSP (Federal Police) on the illegal exportation of mineral ore. The pamphlet had previously received limited distribution to "high military authorities and various civilian authorities," according to the newspaper report. The pamphlet is devoted primarily to the case of the detained Americans, which the DFSP considers the principal proof of widespread minerals contraband gravely affecting the national economy.

In testimony before a congressional committee, DFSP Director Riograndino Kruel alleged that "systematic and impertinent interference of the US Consul -- in fact, a form of external pressure -- greatly hindered responsible police officials in taking the statements of the four Americans." The Embassy issued a short statement on June 8 pointing out that access by consular officers to nationals of their country who are being detained is a well-established

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principle of international law. JORNAL DO BRASIL called Krue's charge "remarkable," noted that the consul was merely doing his duty, and called for an end to the sensationalism surrounding the case. (UNCLASSIFIED)

6. Leftist Gains Reported in Shipyard Union

A former official of the Niteroi Shipyard Workers' Union has reported to the Embassy that several leaders who were active in the pre-1964 revolution CGT are again influential in the union. (CONF)

COMMENT: Although this report of renewed activity by former CGT leaders in this union is not yet confirmed by other Embassy sources, the return of leftist influence in this former stronghold of Communist strength in the State of Rio de Janeiro would conform with the pattern of resurgence of influence in those unions where CGT strength was heavy. The Embassy previously has reported the return of leftist influence in the metalworkers, bankworkers, textile workers, and other sectors. (CONFIDENTIAL)

7. Survey of Economic Scene

A recent Embassy survey of the economic scene indicates that the current level of business activity is high compared with 1965, a recession year, and that some sectors, such as the automobile industry, are producing at record levels. Employment opportunities are believed to have climbed back to end of 1964 levels and private investment to be increasing; although, owing largely to unavailability of funds, private investment is still well below the high levels of the 50's. Agriculture has fallen off somewhat this year compared to 1965's record crops, but not enough to preclude a satisfactory increase in GDP during 1966.

The high rate of price increase experienced during the first five months of 1966, while very disappointing, tends to mask substantial, basic progress toward stabilization, particularly in the areas of fiscal policy and control over credit expansion. This is largely because of the various price restraints which tended to postpone the impact of last year's inflationary forces until early 1966, the relatively low level of demand and plentiful supplies of food products experienced during 1965 in rather sharp contrast to the current situation, and a large number of deliberate price adjustments made by the GOB early this year. Another very important factor was the large means of payment expansion mistakenly permitted by the Monetary Authorities during the last quarter of 1965 in reaction to the recession experienced earlier in the year. This liquidity bulge has financed the early 1966 price level increase, and it has been the success of measures to restrict 1966 means of

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payment expansion which has elicited the much publicized protests of Brazilian entrepreneurs against "credit squeeze."

Assuming a continuation of current economic policies, it is expected that the price level increase can be held to about 30 percent in 1966 and to a lower level in 1967, despite the round of 20-30 percent wage increases now in prospect for the last quarter of this year. (CONFIDENTIAL)

8. State Financial Secretaries Consider Tax Reform

On June 15 the financial secretaries of the various Brazilian states were convened by Federal Finance Minister Bulhões to consider plans for implementing Constitutional Amendment No. 18, which completely reorganizes Brazil's tax structure. This amendment is to be implemented in stages; the removal of export taxes from state to federal jurisdiction, for example, has already taken place while the change-over of state sales taxes from a turnover to a value added basis and the participation of the states in Federal income and excise tax revenues will take effect as of January 1, 1967. Participants in the convention were enthusiastic in their praise of the reforms and made favorable references to assistance received from US technicians. (UNCLASSIFIED)

9. U.S.-Brazil Tax Treaty Negotiations

A U.S. Treasury Department team arrived in Rio on June 11 for a week of negotiations on the proposed U.S.-Brazil income tax treaty. The treaty would attempt to eliminate double taxation by the two countries, create tax enforcement machinery and tend to stimulate US private investment in Brazil. Several unresolved issues are currently complicating the negotiations. Of these, perhaps the two most important are those of providing for deduction of royalty and technical assistance payments of Brazilian subsidiaries to American parent companies from Brazilian taxable income and of exempting income paid to US citizens in the US for services rendered in Brazil from Brazilian income taxation. (CONFIDENTIAL)

10. New Foreign Trade Law

President Castello Branco has signed into law the foreign trade bill passed by both houses of Congress earlier in May. The law centralizes the function of policy-making, promotion and control with regard to exports in a new inter-ministerial body, CONCEX, for which the foreign trade department of the Bank of Brazil (CACEX) will act as executive secretariat. CACEX will also administer a new Export Financing Fund established by the law for the principal purpose of financing the exports and export production of manufacturing enterprises.

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Under the new law reciprocity is extended with respect to the payment of fees for the legalization of consular invoices. Thus, the United States which does not charge for this consular formality will be exempt from the future payment of fees for legalization of invoices covering exports to Brazil. On the other hand, the existing Merchant Marine Improvement Tax of five percent on the net ocean freight charges pertaining to both imports and exports is now cancelled with respect to exports but doubled on imports.

President Castello Branco vetoed a provision in the new law authorizing CONCEX to form or join export corporations, thus preventing a possible large-scale entry of the Brazilian Government into the export business. (UNCLASSIFIED)

ALLIANCE FOR PROGRESS11. Sugar Zone Modernization Program

The general outlines of a comprehensive modernization and resettlement program for the politically volatile Northeast sugar zone were approved last week in Recife by GERAN, a GOB coordinating council under the leadership of SUDENE in which also participate the heads of IBRA, INDA and the Sugar and Alcohol Institute. Elaborated by a working group over the past several months with behind-the-scenes assistance of USAID/Recife staff members, the five-year projected program provides incentives for sugar estate owners to modernize their production facilities in exchange for giving up sizable amounts of land for the resettlement of sugar workers displaced by the modernization program. The plan also visualizes a number of corollary efforts in crop diversification, vocational and literacy training, health improvement, and industrial job creation. Total costs of the five-year program for the sugar area might run as high as \$500 million, roughly 20 percent of which might be sought from international financing agencies. (UNCLASSIFIED)

COMMENT: The program carries the strong endorsement of newly appointed Minister for Regional Coordination, Dr. João Gonçalves de Souza, and reportedly also endorsement in principle by the President. Nonetheless, it will undoubtedly require several months to set up the complicated organizational arrangements visualized for execution of the program, and there are a number of potential conflicts between IBRA and GERAN over the resettlement aspects of the effort. (LIMITED OFFICIAL USE)

12. Use of Foreign Engineers in AID-Financed Contracts Attacked

Protests largely by professional societies against the use of foreign engineering firms and foreign consultants on projects

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financed by AID, IBRD, and BID have recently been growing in intensity. In the past weeks this issue has shifted from complaints about the lenders' policies to sharp criticisms of the GOB, especially Planning Minister Campos. Campos' acceptance of US policy requirements that foreign firms must be eligible on an equal basis to bid on foreign-financed projects or feasibility studies is being cited as another example of "entreguismo."

Opposition Deputy Amaral Neto has made two speeches in the Congress specifically accusing the Ministry of Planning of favoritism to US engineering firms. He asserted that this was being done despite assurances by former Ambassador Gordon that preference would be given to local firms. This speech was reprinted as a paid advertisement in Rio newspapers. Campos also testified on the issue this week before one of the Chamber committees in a fiery session during which Campos' charges that the criticisms were "the product of mental underdevelopment" caused the opposition members to walk out en masse. To clarify Neto's misinterpretation of US policy, the Embassy issued a statement on June 13 indicating that Brazilian firms, US firms, or joint ventures between US and Brazilian firms were eligible without discrimination to carry out engineering services on AID-financed jobs, and that choice of the firm was left to the discretion of the Brazilian borrower.

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