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DEPARTMENT OF STATE
BUREAU OF
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Brazil is now passing through a crucial phase in its history. The revolution of March 31-April 1, 1964 turned out of power leadership elements which had brought Brazil to the brink of economic and political ruin. Corrupt, weak, inefficient, and irresponsible, this leadership represented directly, or through its political maneuvering permitted to flourish, all the worst elements in the Brazilian body politic, from negative ultra-nationalists at one end of the political spectrum to communists at the other. In the economic sphere, its actions reflected the statist and paternalistic economic and social philosophy of Getulio Vargas' "Estado Novo" combined with a more virulent xenophobia toward foreign private capital and enterprise and a greater degree of fiscal irresponsibility than Brazil had hitherto known. Politically, it fostered disunity within the country and -- partly by design but perhaps even more as a by-product of its maneuverings designed to consolidate its hold on power -- a dangerous growth in power and influence of the communists and other extreme leftist groups. In its international posture it was becoming increasingly neutralist and anti-American.

The revolution gave leadership to forces which are in many ways the antithesis of the Goulart administration. The integrity of the Castello Branco government is widely recognized even among its enemies. It has been successful in greatly diminishing corruption in government, although its public image in this regard is marred by its unwillingness to take direct action against Governor Adhemar de Barros, whose virtues as a supporter of the revolution are regarded as outweighing his sins of corruption.

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It has moved courageously to stem inflation by raising taxes, cutting expenditures, eliminating import and other consumer subsidies, and controlling bank credit, to re-establish Brazilian international credit, to encourage the flow of private foreign capital to Brazil, and to provide increased opportunities for expansion of the private sector of the economy. In contrast to the Goulart administration, which used "reform" only as a political slogan, the Castello Branco government has embarked on genuine and much needed reforms in agriculture, housing, and banking, and has made a start on the complex and difficult problem of reforming the government administration. It has turned its back completely on the demagoguery of the Goulart administration. It has, in fact, carried this virtue to the point of a fault, proceeding doggedly to administer the bitter medicines which are needed to cure Brazil of the illnesses acquired under past administrations, while appearing, at times, to ignore public opinion. The government is solidly anti-communist. Eschewing completely the negative nationalism of Goulart, it has made Brazil a responsible and constructive member of the inter-American system and a positive force for defense of freedom in the world.

In short, the new government has turned its back on the excessive statism, the over-indulgence of consumers and organized labor, the catering to special interest groups, the easy credit policies and deficit financing of public expenditures, and the economic nationalism which for decades have frustrated the attainment of the great potential which has long been ascribed to Brazil. It has set Brazil on a path which, if it can be adhered to long enough, holds promise of rapid economic and social progress, and the emergence of Brazil in the not distant future as a modern nation enjoying free institutions and capable of self-sustained economic growth.

It is not to be imagined, however, that the revolution provided the forces now in power with a definite and conclusive victory. The forces which have mismanaged Brazil for so long are still numerous, powerful, and vocal in their criticism of the present government. They and their policies will be finally discredited only if the policies of the present government yield demonstrably more rapid progress and increased

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economic and social welfare. Thus, the revolution is to be regarded as providing the forces represented by the Castello Branco government with an opportunity, rather than a final victory.

Eleven months after the revolution the accomplishments of the Castello Branco government are already impressive to the objective observer. It has made great progress toward putting into manageable form the mass of short-term external debt which a year ago threatened Brazil with bankruptcy. It appears to have set the stage for a very considerable influx of foreign private capital over the coming months. Most important of all, it has slowed to a trickle the supply of fuel to the engine of inflation provided by the budget deficit, although the engine continues to move forward largely under the impetus of its own momentum.

Despite these accomplishments (or perhaps because of them) the government is not popular. The government's stabilization program has induced a very substantial recession in business. Important business failures have occurred and more are in prospect. Consumers are not happy at being forced to pay more for such things as bread, petroleum products, electric power, rented living quarters, and public transportation and communications services. Labor resents the government's efforts to hold down wage increases while prices continue to rise. While few businessmen would wish to return to the conditions of the Goulart period, most of them are opposed to the tight credit policies and the heavier tax burdens imposed by the present government. The ultra-nationalists have been offended by the government's efforts to attract foreign private capital. Thus, while the government has demanded sacrifices and in other ways roused the opposition of many segments of society, it has not been able as yet to deliver very much in the way of tangible benefits.

Although not popular, the government, and especially President Castello Branco himself, commands a considerable degree of respect. It continues to enjoy the broad support of the military establishment, and there is little prospect that it will be removed by unconstitutional means or forced to modify markedly its program for the stabilization,

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development, and reform of the economy. The next great test of whether Brazil can continue along the route which its present leaders have charted for it is therefore likely to take place in the national elections scheduled for November 1966.

While the Castello Branco regime has moved vigorously to reshape the economic life of the country, it is only now beginning to address itself to the problems of political reformation. There seems to have been a tendency to react to political developments rather than to seize the initiative to shape political phenomena to the revolutionary mold. Thus, the shape which the coming political contest will take remains far from clear. Who will be the principal candidates for the presidency, whether Castello Branco will himself be a candidate, whether there will be a formal restructuring of political parties and, if so, its nature, are moot questions at present. It appears certain that the government in coming months will give much higher priority than in the past to providing answers to these questions which are satisfactory to it. Whatever shape the coming political struggle takes, however, the likelihood of a continuation of the present government's policy line in the years beyond 1966 will depend in considerable measure on the success which the government is able to demonstrate for its economic and social policies this year and next.

The most important short-run objective of United States policy toward Brazil ought, therefore, to be to assist the present government and its backers to the utmost to exploit the opportunity provided by last year's revolution. In the realm of economic policy this will mean supporting in generous measure the efforts of the Castello Branco government to stabilize the economy and put Brazil on the road to prosperity and rapid economic growth. In contrast to the economic assistance provided the Goulart government, which could do no more than slow down the rate of economic and political deterioration, aid extended to the present government offers the possibility of very great returns in the form of rapid economic progress, which within a decade or less could put Brazil in position largely to finance its own future development. The amount of economic assistance made available to Brazil over the next few years from all free world sources therefore should be limited

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only by the country's capacity to absorb it usefully and efficiently for economic development. While it will be no simple matter to proceed from this criterion to the fixing of aid levels, the criterion will provide a useful general guide to the establishment of aid policy with respect to Brazil while the prospects for good returns from such assistance remain as favorable as they are at present. Measured against this criterion, no serious fault can be found with United States aid policy since the revolution. Viewed in retrospect, what seemed to many Brazilians to be unnecessary and undesirable delay in putting together last year's aid package appears to have been wholly justified by the improved planning made possible and stimulated by this delay, while the magnitude of the package appears roughly to meet the above criterion. It is of great importance, however, that the pace of implementation not be hampered by unnecessary administrative obstacles.

With respect to policy to be followed by the United States in providing technical assistance to Brazil, two considerations are fundamental. First, there are indications that Brazil is at a critical phase in its process of institutional reform and modernization, and that the next five to ten years could constitute a basic turning point in its whole institutional performance. Secondly, for the present, at least, there exists a general disposition in Brazil to look to the United States for technical assistance. While some decrease in the diffusion of our present technical assistance efforts may be desirable, we should aim at providing technical assistance to bring about the effective implementation of those elements of Brazilian institutional reform or modernization which meet three tests: (a) they are of critical importance to the nation's economic and social progress; (b) a significant difference can be made in the time period or in the effectiveness of the results through the provision of outside technical assistance; and (c) the United States possesses relevant resources which can be mobilized by AID.

The foregoing policy considerations provide the basic framework within which the review of the assistance programs for Brazil in FY 1967 through FY 1970 requested by AIDTO Circular X-942 is being conducted by the Embassy and related organizations.

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Another economic policy area important in affecting both our relations with Brazil and Brazil's future rate of economic progress is that of trade. While the extreme posturings and demands of the Goulart period for trade concessions by the developed to the under-developed countries are a thing of the past, there remains both within the Castello Branco government and among educated Brazilians generally a strong conviction that positive steps need to be taken to improve the conditions affecting the trade of less-developed countries in general, and Brazil in particular. The present government's desire to substitute "trade for aid" as rapidly as possible is evident from its determined efforts to promote exports and was stated explicitly in Castello Branco's letter of January 8, 1965 to President Johnson.

Having taken a long step forward several years ago by playing a leading role in the creation of the International Coffee Agreement, US policy over the past year, as seen from Brazil, has fallen somewhat short of full support for the institution which it helped to create. Since a price of 25 or 30 cents per pound would be sufficient to assure production of all the coffee the world can consume, it is implicit in US official satisfaction with the present level of prices that Washington accepts as a legitimate purpose of the Agreement the transfer of a certain amount of resources from the wealthy consuming countries to the poor coffee-producing countries. The long delays in enacting legislation to enable the United States to fulfill its obligations under the Agreement, and the negotiating positions sometimes adopted in London have revealed a reluctance to accept the restrictions on our own freedom of action in the coffee market which will be inevitable if this purpose is to be accomplished. A more positive role by the United States will be necessary if the Agreement is to be developed into an effective instrument for accomplishing the purposes originally intended for it.

United States policy with respect to the other trade demands voiced by the less developed countries at the 1964 United Nations Conference on Trade and Development also requires better definition. Thus far the posture of the United States with respect to these demands has not convinced Brazilians that the qualified acceptance in principle by the United States of some of these demands constitutes more than lip service. A

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more intensive effort by the United States to gain the initiative in this area, and to escape from its present equivocal and defensive position, would be highly desirable. The possibilities of providing Brazil and other Latin American countries with improved trade opportunities within the framework of a Western Hemisphere trading system need more intensive examination than they have received to date.

The recent decision to increase significantly the level of military assistance to Brazil by supplementing grant assistance with credit assistance is welcomed by the Embassy. While helping in a small way to reduce the burden of military purchases on the Brazilian balance of payments, it should also help to reduce the tendency of the Brazilian military in recent years to look increasingly to other countries as potential alternative sources of supply. It should result in improved planning of materiel purchases. The most important effects may be intangible psychological and political ones. The Brazilian military establishment is normally an important constructive and stabilizing force in Brazil's political life. However, as architect and instrument of the 1964 revolution and an important source of support for the present government, it is likely to play an unusually important role in influencing the crucial political decisions which will be made over the next two years.

In any circumstances the "style" of US policy and actions with respect to Brazil must take into account the peculiarly virulent and sensitive Brazilian nationalism, which stems in part from the Country's size and relative importance in Latin America and in part, perhaps, from its past failure to realize more fully its potentialities. In present circumstances it will be desirable to be more than normally aware of these sensitivities. The Castello Branco government has taken a number of constructive steps of special interest to the United States--the American and Foreign Power Company purchase, the revision of the profits remittance law, the new iron ore export policy, and the signature of an investment guaranty agreement--which have laid it open to criticism from the nationalists. It seems certain that a principal campaign theme of the opposition candidate or candidates in the coming elections will be that the government has been "entreguista", that is,

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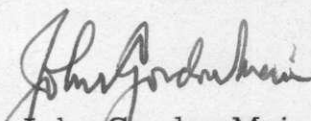
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that it has been pliant in the hands of Uncle Sam. In placing demands on Brazil it will therefore be necessary to weigh carefully the advantages to be gained by the United States against the advantages which we may provide to the opponents of the present regime in Brazil.

For the Ambassador


John Gordon Mein
Deputy Chief of Mission

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