

BB FORM
NO. 38

ROUTE SLIP

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EXECUTIVE OFFICE OF THE PRESIDENT
BUREAU OF THE BUDGET

DATE November 21, 1962

TO: Mr. Ralph Dungan, White House

FROM: K. R. Hansen

REMARKS: As we discussed this morning,
attached is the Rostow paper. I
do not necessarily concur in the final
paragraph, except as part of the scenario.
Clearly the key is to step in heavily on
the political side and keep our powder dry
on this matter of providing financial
assistance.

Attachment

CC Memo fm Rostow to Edwin Martin,
11/14/62

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November 14, 1962

TO: ABA - Mr. Edwin Martin
FROM: S/P - W. W. Rostow
SUBJECT: Comments on the Draper Report

Herewith, as requested, my comments on the Draper Report.

1. Underlying the Draper Report is a possible implication which should be squarely faced; namely, that US policy should consciously aim at the removal of Goulart and the creation, if necessary, of a military dictatorship. Although I am acutely aware of dangerous trends in the pattern of Goulart's policy and political behavior, I believe it is too soon for us to conclude that he is either determined to or capable of creating a Castro-type dictatorship in Brazil or that he is otherwise a lost soul from our point of view. Moreover, I am not confident that the outcome of his overthrow would be orderly and effective, if autocratic, military rule. Nevertheless, the ambiguities and doubts about Goulart justify systematic contingency planning on a number of possible situations and alternatives which might arise (or might be made to arise) in the next six months or so.

2. The Draper Report correctly identifies the major economic problems of Brazil:

a. A rate of population increase which is dangerously outstripping the rate of build up of social overhead capital, notably in the fields of housing and education.

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b. The failure of Brazil to allocate adequate resources and technical assistance to the development of its agriculture, for both domestic and export purposes; and a more general failure to generate export earnings.

c. The failure of Brazilian (and U.S.) authorities to come to grips with sufficient energy and on an appropriate scale with the grievous problem of the northeast.

d. The failure of the Brazilian authorities to develop an adequate monetary policy: specifically, "to make substantial progress towards a balanced budget by eliminating the huge subsidies to the railroads, the merchant marine, and the other state enterprises, and so making these services pay their own way; by cutting unnecessary and unproductive personnel and other expenses; by increasing tax rates and by improving tax collections. The Government will have to develop and firmly administer a proper wage policy... Finally, more flexible and realistic foreign exchange rate and other policies must be adopted both to encourage exports and an inflow of capital, and to discourage unnecessary imports."

3. The weakness of the Draper Report comes to this: it correctly identifies a series of major structural distortions in the pattern of Brazil's investment outlays and in its institutional arrangements governing public services, finance, and foreign exchange policy; but its prescriptions -- in conventional monetary stabilization terms -- do not promise to correct these distortions. The Draper Report holds that what we first need is a phase of monetary orthodoxy; and then Brazil could proceed with balanced growth without inflation. This, in my view, is not a technically correct view.

4. As I pointed out at the LAPC meeting, when General Draper spoke, structural problems of the kind identified in

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the report cannot be solved by the kind of quick stabilization measures undertaken in the postwar years in Japan and Germany. They come closer to representing the sort of problems faced in the immediate postwar years in Italy, France and Greece - problems that yielded only after a protracted two-pronged effort: one prong directed to an expansion in the level and an improvement in the pattern of investment; the other prong addressed to a series of concrete measures designed to improve tax collections; the handling of public services (including, in the French case, the government regulation of rents); and foreign exchange policy. When a monetary system is as structurally distorted as Brazil's or Italy's (as of 1947) one requires a five-year stabilization program, not a quick-fix.

5. What is required in Brazil, then, is the design of a protracted program addressed to both the monetary and development sides of the economic equation; a one-shot drastic monetary effort will evidently not suffice, quite aside from the fact that it would be politically unacceptable.

6. It does not follow from my criticism of the Draper Report, however, that we should not put pressure on Goulart to undertake certain initial steps to increase tax collection and to do other worthy things that the IMF might recommend in the near future. But what is essential is that we and the Brazilians come to an understanding that despite their high over-all rate of growth, the distortions in their pattern of growth are creating economic, social and political problems of extreme danger to themselves and to the hemisphere. The vitality of the private enterprise sector in southern Brazil - a rare and precious asset, which the Draper Report does not take fully into account - is no substitute for an over-all policy which comes to grips with the five major structural problems that the Draper Report correctly identifies.

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7. It is my recommendation, therefore, that at some politically appropriate time the President write to Goulart stating specifically the character of our concern with the fate of the Brazilian economy; identifying the major problems which we feel must be addressed in the context of the Alliance for Progress; committing ourselves to work systematically with Brazil towards their solution if Goulart will commit himself and his government to the effort; and suggesting, perhaps, the design of a joint U.S.-Brazilian program on which our representative would be Ambassador Gordon.