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DEPARTMENT OF STATE

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A-687 — NO.

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PRIORITY — HANDLING INDICATOR: Brazil

1963 DEC 11 PM 4 00

TO : DEPARTMENT OF STATE

INFO : BRASILIA, BELEM, BELO HORIZONTE, CURITIBA, PORTO ALEGRE, RECIFE, SALVADOR, SÃO PAULO

DISTRIBUTION BRANCH

DEC 6 1963

FROM : Amembassy RIO DE JANEIRO DATE: December 6, 1963

SUBJECT : Publication of Article by Ambassador Lincoln Gordon

REF :

JOINT STATE/USIA MESSAGE

Following herewith is an article prepared by Ambassador Lincoln Gordon for publication in the special supplement of the Jornal do Brasil on Sunday, December 8, 1963. It will also be published in the Estado de São Paulo on the same day.

- -

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Dialogue, Trade and Aid

In recent months, the editorial columns of the Jornal do Brasil have repeatedly emphasized the importance of a constructive dialogue between Brazil and the United States concerning the relations between our countries and the major questions of international policy which are of importance to both of us. This is an objective with which I am wholeheartedly in agreement.

Obviously dialogue does not exclude differences of viewpoints. It may even thrive on such differences. But for dialogue to be constructive, it should begin with an effort to examine objectively the relevant facts--including consideration of which facts are relevant. On the facts themselves, there should be no differences of opinion. There should also be a serious effort to analyze the reasons for a given historical evolution, and its implications for the future.

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Drafted by: LGordon:mls

Contents and Classification Approved by: Lincoln Gordon

Clearances:

On this basis, various national policies for affecting this future evolution constructively can be considered. Some of the policies may be unilateral; some may require bilateral cooperation; some may require international multilateral action. On policy, as distinct from facts, divergences of national interest are likely to come into play. Here the task of constructive dialogue is to seek the highest common factor of agreement, reconciling interests as far as possible and identifying areas of convergent interest where joint action may advance the common cause. If this kind of dialogue has been possible between the Soviet Union and the United States and Great Britain with respect to nuclear tests, surely it should be possible between Brazil and the United States with respect to trade and aid.

A good starting point for a dialogue on this subject is the article by my good friend and opposite number in Washington, Ambassador Roberto Campos, published in the Caderno Especial on November 17, under the title "Trade Opportunities for the Less Developed Countries." The article had already appeared, with supplementary statistical tables, in the Revista do Conselho Nacional de Economia for September-October, and was in fact originally prepared for an American audience at the beginning of this year.

The Campos article makes two major factual points, on which there is no disagreement. First, that between 1953 and 1960, the share of less developed countries in world trade fell from 55 to 47 percent. Secondly, that during the same period, world prices of primary products fell from an index of 100 to 93, while for tropical products the fall was greater (from 100 to 63 in the case of coffee).

From these agreed facts, however, Ambassador Campos derives calculations as to the "cumulative potential receipts" of foreign exchange which Brazil "failed to receive" in the years following 1953 as a result of reductions in export prices. These "lost earnings," he states, were much greater than the amounts of foreign assistance received by Brazil during this period of years.

Ambassador Campos goes on to make clear that he does not believe that these price movements reflected any conscious or deliberate process of exploitation by the industrialized countries, and that certain policies of the underdeveloped countries which stimulated the overproduction of primary products contributed directly to the fall in prices. He states that the only purpose of the arithmetical comparison is to demonstrate that the amounts of foreign aid being provided by the United States do not really represent a severe burden for the American economy.

Unfortunately, other commentators have drawn from the kind of figures analyzed by Ambassador Campos entirely different conclusions. At the recent São Paulo meeting of the Inter-American Economic and Social Council, for example, there were several references to the "implacable deterioration" in the export prices and terms of trade of the Latin American member countries. Some statements

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implied that this was an important contributing factor to the inflationary pressures in many parts of Latin America. In public discussions of this problem in the press and elsewhere in Brazil, it is common to hear charges that--contrary to Ambassador Campos' views--these price falls are a result of deliberate exploitation, if not by the governments of the United States and other industrialized nations, at least by American and European business interests. There are references to the "bleeding" of Latin American economies. And finally, the statement is often made that if Latin America could only receive "just prices" for its primary product exports, there would be no problem of shortage of foreign exchange, shortage of investment funds, or other need to be interested in foreign aid or foreign private investment.

That foreign aid provided by the United States in recent years does not constitute an undue burden upon the American economy is a viewpoint with which successive United States administrations have been in full accord. This has repeatedly been stated in defending foreign aid bills before our Congress. The other inferences, however, are not only unwarranted by the facts but tend to make constructive international dialogue more difficult if not impossible.

As Dr. Raul Prebisch, the secretary of the forthcoming United Nations Conference on Trade and Development, said at the São Paulo meeting, "every calculation of the price relationships of trade has a point of departure, and depending on what point of departure is selected, the amount and importance of deterioration and of consequent loss for the developing countries is greater or less." The repeated statements of those who refer to "implacable deterioration" in export prices, or of "selling constantly more in return for constantly less" always take 1953 or 1954 as the base. But the world did not start in 1953. As I shall show below, 1953 was actually an abnormally favorable year for tropical export prices, notably of coffee.

It was in an effort to place the dialogue on a more constructive basis that I devoted my conference at the National Economic Council to this subject last January. The full text was published in the Revista of the Council for March-August 1963 (Year XII, No. 2, pages 195 to 203). The available space here does not permit a reiteration of all the points made at that time. The essential weakness of arguments based on the price levels of 1953 or 1954, however, appears clearly in the following charts. The first chart shows the purchasing power of coffee in world trade and the terms of trade for all Brazilian exports and imports during the 43 years 1920-1962. The second chart shows the actual New York price for Brazilian coffee in the postwar years.

As will be seen from the charts, 1953 and 1954 stand out like Mount Fujiyama in a Japanese print. The first chart also shows--and I call this especially to the attention of those who refer to "implacable" or "continuous" deterioration in export prices--that the recent eight-year period (1954 to 1962) of price falls was preceded by no less than 16 years (1938 to 1954) of almost continuous price increases.

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In his article, Ambassador Campos justified the use of the year 1953 as a base, on the ground that it preceded the "abnormal and artificial increase" experienced in 1954 and was more or less equal to the level of 1955 and the immediately following years. This is a little like saying that because he did not select the summit of Fujiyama, therefore a point high on the mountain's shoulder is a normal base. It is a matter of common knowledge that the spectacular price rise from 1949 to 1950 resulted from the coincidence of the Korean War with the temporary exhaustion of excess coffee stocks in Brazil. And the second spectacular rise in 1954 resulted from the Paraná frost, accentuated by speculative manipulations on the world coffee market. Had it not been for the Korean War, prices in 1953 would certainly have been a good deal lower. To use 1953 prices as if they represent some sort of price "normalcy" or "just price," therefore, is extremely questionable. And to use 1954 prices in this manner is simply absurd.

It follows that the calculations on "foreign exchange losses" resulting from price declines since 1953 or 1954 are no more than an interesting exercise in arithmetic. If one takes as a base the average postwar coffee price of 44.9 cents per pound, and applies to it the same sort of calculations used in the Campos article, the result is that Brazil not only did not suffer a "loss" of 2.4 billion dollars; it actually enjoyed a modest "gain" in foreign exchange receipts from 1953 to 1962. More precisely, actual receipts were 8 million dollars <u>higher</u> than they would have been if the price of 44.9 cents had obtained throughout those years.

Nor is there much to be gained by an abstract discussion of what price levels for coffee or other commodities might be considered "just." Any price sufficiently rewarding to producers to persuade them to expand production can be considered an economic price, and this has been true of coffee prices throughout the postwar period. From the viewpoint of Brazil's earnings of foreign exchange, there are two hard facts about this postwar coffee market. First, prices were always high enough to stimulate a continuous increase in world production, especially in Africa and in certain other Latin American countries, but also within Brazil itself. Secondly, the share of Brazil in world exports was almost steadily falling, being reduced from 53 percent at the close of the war to only 39 percent in recent years. Moreover, world overproduction and the consequent accumulation of stocks threatened a drastic collapse in the market, with the most serious economic consequences for the producing countries.

It was for this reason that all major consumers and producers were brought together, under the joint leadership of Brazil and the United States, to negotiate the World Coffee Agreement which has just begun to operate. No one would claim perfection for this agreement, but it is certainly an important advance over any previous accords of this type.

What can reasonably be expected from international cooperation in regard to basic commodity markets, bearing in mind that such cooperation must enlist the support of consumers as well as producers and must reconcile the divergent interests of competing producer groups? I believe that such cooperation can achieve four basic goals: (a) to avoid excessive fluctuations in prices, especially of a speculative character; (b) to promote long-term equilibrium between supply and demand, thus avoiding the wastage of resources in overproduction and the holding of useless stocks; (c) to remove unnecessary obstacles to market growth, such as tariffs or excise taxes on tropical products (it should be noted that the United States imposes no such taxes on coffee or cocoa, in contrast with most of Europe); and (d) to promote price levels which provide adequate remuneration to producers and leave a substantial margin for tax revenue for the governments of the producing countries.

The repeated references to coffee prices of 1953 to 1955 make one wonder whether some spokesmen for the producing countries cherish the hope that international action might support a price structure far in excess of what is suggested above, as a contribution to development in the tropical countries. What this really comes down to is a plea for large-scale aid in disguise. It is difficult, however, to see why such a policy should be accepted by the more industrialized countries. If they are prepared to provide large-scale aid for economic development, as the United States has shown itself to be, why should such aid be distributed arbitrarily in proportion to the production of a few selected commodities, such as coffee or tea or bananas, which are produced in some underdeveloped countries but not in others? And what assurance would there be that the resultant aid would be used for constructive objectives?

Moreover, if the history of commodity stabilization agreements is any guide to the future, it suggests that prices far in excess of production costs (plus a reasonable margin for export country taxation) inevitably lead to the collapse of the agreement because some producers break away from it in order to profit by the very high prices. This in turn leads to new overproduction, the accumulation of stocks which again overhang the market, and a repetition of the cycle of drastic fluctuations which the commodity agreement was designed to cure. At the same time, the excessively high prices stimulate the development of substitutes, thus permanently reducing long-term world market demand.

These observations are in no sense intended to disregard the existence of real and serious trade problems facing the underdeveloped countries. It is indeed a fact that world markets for most primary products have been growing more slowly than the markets for manufactured goods, mainly as a result of synthetic substitutes and greater efficiency in the use of raw materials. It is also a fact that the availability of foreign exchange to finance imports of capital goods and raw materials not produced at home is one of the significant limiting factors on the pace of development. There is much room for international cooperation to enlarge the market opportunities for the less developed countries, partly in traditional exports but even more in new lines of export which should be stimulated. As Europe has demonstrated, whole new dimensions can be opened up through regional integration.

The United Nations Conference on Trade and Development should identify many specific lines of positive action for improving the trade projects of the underdeveloped countries. But these actions should focus mainly on the potential growing points in world trade and on the removal of obstacles to such growth. If they are diverted into mere efforts to secure massive worldwide financing of the overproduction and overstocking of products which world consumers neither want nor need, the result is likely to be mere frustration.

In the case of Brazil, fortunately, there is a visible and feasible alternative to wishful thinking about prices for traditional commodities far in excess of the levels which world supply and demand could justify. This alternative results from the fact that Brazil is rich in a variety of resources, which make possible a large expansion in exports of nontraditional commodities. Moreover, Brazil is not a mere producer of primary products; it is, as the United Nations World Economic Survey repeatedly indicates, now in the category of "semi-industrialized nations." For these reasons, I have stressed in earlier statements the great opportunities for improving the balance-of-payments situation through expanded exports of iron ore, of meat (which is more an industrial product than a primary commodity), and of manufactured goods.

Much more than the smaller countries of Latin America, or many of the new countries of Africa, Brazil has within easy reach very large new export opportunities, both within the Latin American Free Trade Area and in the world at large. In this connection, Ambassador Campos on July 24 of this year identified a whole series of policies which might stimulate exports of new products. He summarized his points by saying: "In my view, we should talk less about economic emancipation and pay more attention to exportation; because unless we export more, we will never emancipate ourselves from our creditors. Instead of crying about the fall of prices of traditional exports, we should develop nontraditional exports, following the example of what Japan is doing in Asia, and Mexico and Peru in Latin America."

It is in this connection that aid and trade are directly interrelated. It is often said nowadays that attention should be concentrated on trade rather than aid, because aid is a "mere palliative" whereas trade is a permanent source of economic well-being. Obviously, aid in the sense of the bilateral provision of public funds is not a policy for all future time, although one may hope that an ample flow of private international investment and of loans from such institutions as the World Bank may continue indefinitely. But when the trade structure is inadequate and unsatisfactory (and on this point there is no disagreement), the essential means of remedying it is through export diversification. This in turn requires not only favorable policies, but also investment, technology, and organization--in short, it is an essential part of the very process of economic development.

If aid is applied to bringing about these structural changes, through productive investment in economic and social infrastructure and in new industrial and agricultural enterprises, it will make possible within a few years the expanded participation in world trade which long-term economic prosperity requires. This is precisely the way Europe utilized the aid provided under the Marshall Plan. It was not a "mere palliative"; it was a vital resource employed to finance an important share of the investments essential to European economic recovery. A similar objective was explicitly recognized in the Charter of Punta del Este as one of the goals of the Alliance for Progress. As Mr. Averell Harriman said on behalf of the United States Delegation at the São Paulo meeting, "With both aid and trade, these structural changes can be greatly accelerated. Thus the problem is not one of a false choice between trade and aid, but rather the best combination of both."

In conclusion, I should like to emphasize the special importance of private foreign investment in the manufacturing sector to this process of export diversification. If Brazil enjoys today, as it does, substantial prospects for manufacturing exports to other countries of Latin America and in due course elsewhere in the world, this is due in large measure to the contributions which foreign investors have made to the development of manufacturing industry in this country. And if the process of freeing the Brazilian economy from excessive dependence on the export of a few traditional primary products is to be completed, there will be required much greater industrial expansion and diversification, taking advantage of the most modern techniques being developed in the industrialized advanced countries. There is no more effective or more rapid way of securing this expansion than by the encouragement of direct foreign investment, working in close cooperation with Brazilian industry.

Lincoln Gordon

Lincoln Gordon

att.

Enclosures:

1. Chart I.
2. Chart II.

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BRAZILIAN TERMS OF TRADE, 1920 - 62 ....

PURCHASING POWER OF COFFEE, 1920 - 62 ————

INDEX 1962 = 100

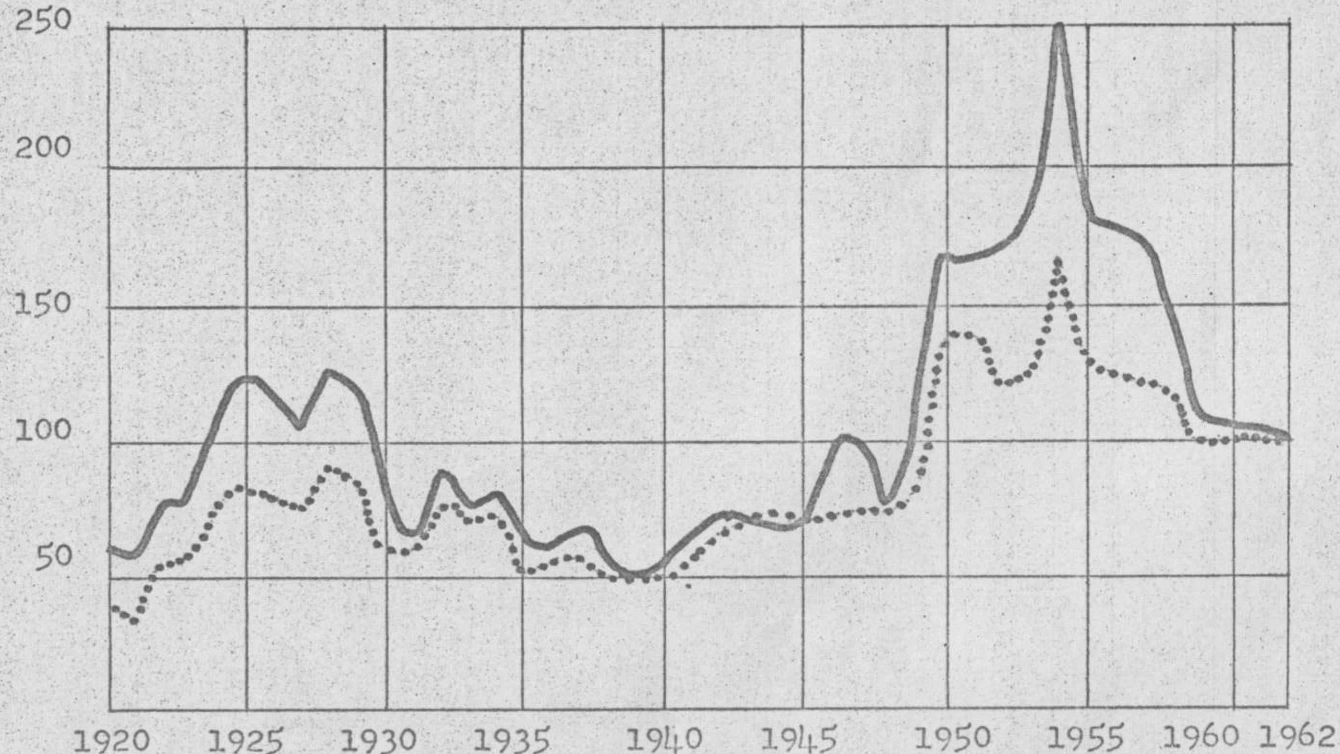

CHART I

Encl. No. 1 to Rio A-687

COFFEE PRICES, 1946 - 1963

Santos 4 in New York (Cents per pound)

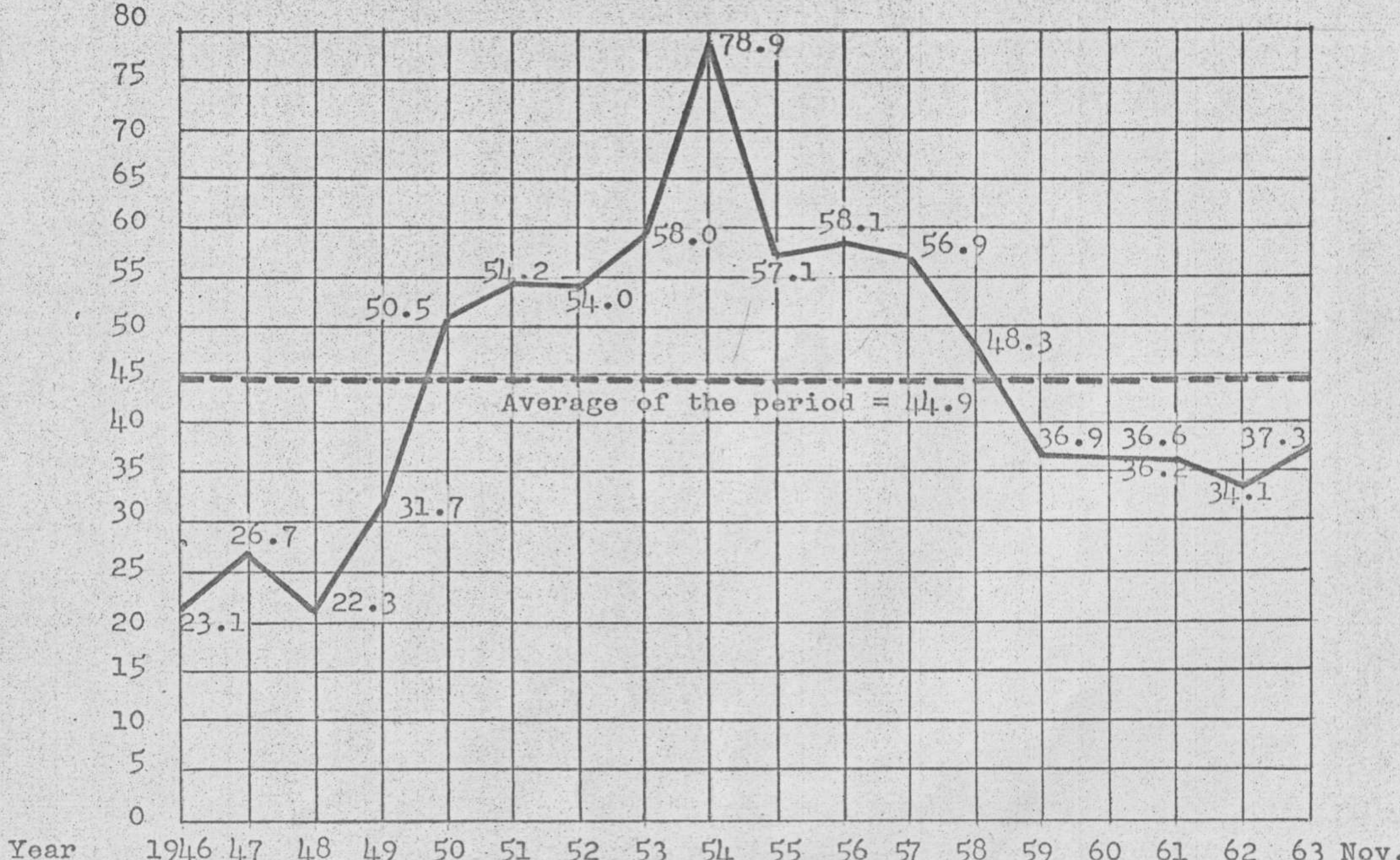

CHART II

Encl. No. 2 to Rio A-687