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Memorandum to: Mr. Teodoro Moscoso, Deputy Administrator for Latin America Agency for International Development

From: Roberto de Jesus Toro

Subject: Report on Brazil

The Background

Brazil is in serious trouble. It is politically, economically and sociologically sick. The cause of its disease is political. The country is in a disturbingly confused state. Its leadership is indecisive; its governing system uncertain and ineffective. Brazil is drifting aimlessly deeper and deeper into a possible chaos under a makeshift political regime, which lacks adequate popular support. More than eight months have passed since the dramatic abdication of President Janio Quadros and the country is still in a quandry, with the economy worsening. The new "parliamentary" system just isn't working. Laws go unpassed because there are rarely enough members of Parliament on hand in Brasilia to form a quorum. There is, in reality a political vacuum.

This political vacuum must soon be filled by constructive democratic forces or there will be a revolutionary explosion on the extreme right or left.

Brazil has little experience with democracy. Since 1889, most of its governments have been dictatorial. The few periods of "democratic" government, such as Dutra's and Kubitscheck's have not been inspiring. There is no history of party responsibility. More than nine parties (all of them split within) rival one another. Voters elect personalities and not parties.

But these leaders are frequently venal, corrupt, demagogic, aimless. This situation is generally true throughout the political fabric. The result is growing disillusionment, frustration, skepticism amongst the voters; there is a growing feeling that democracy doesn't seem to work.

The political economic organizational structure of Brazil is totalitarian in form. The structure of labor and employer syndicates was created by Getulio Vargas, closely-patterned after the Italian Fascist Corporate State. It provides for a system of varied workers' social assistance in exchange for a closely regimented governmental control from the top down. The government is supposed to fix the rules of the game between workers and their employers.

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But the whole corporate economic system seems to be breaking down. In the first place, the labor syndicates are not functioning well. Most labor leaders are politically subservient to the Labor ministry, since they depend on him for many of the political plums; not on their workers. The labor courts, the social security system and other agencies provide the political sinecures, for those labor leaders who behave. The small but restive group of free democratic labor leaders is at an obvious disadvantage in their fight for the workers' allegiance.

Caught in the dizziest inflationary spiral in Brazil's inflation-ridden history, the present regime has done little to stop the wage-price spiral. In fact, President Jao (Jongo) Goulart, a prime co-architect of the inflation of the Fifties as a wage-boost proponent and public spender par excellence, seems to be totally unconcerned. Inflation at present is proceeding at the rate of approximately 40% - 50% per annum. A startling 40% budget deficit is the principal cause. It results from the enormous losses of the government public corporations (autorquios), such as oil production and refining, railroads, shipping and others. This situation is likely to get worse with the operating deficits to be expected from the foreign-held public utilities soon to be nationalized under the Kennedy-Goulart understanding.

What is even more surprising, there doesn't seem to be a vibrant, strong opposition to this vicious inflation. Most people will agree that it has gone too far but even bankers seem to be resigned to "some" inflation.

Of course, this galloping inflation makes it impossible to plan any reasonably coherent economic and social development program. The low and low-medium income groups are principally hurt. Their wages usually lag behind prices; a large housing development program is impossible; there is no incentive to capital formation thru savings by the masses of citizens. The working masses don't understand the economic issue, but they certainly feel its effects; and it is painful.

Communist agitation, infiltration and economic sabotage is an integral part of the picture. Most persons we talked to confirm that the relatively small Communist Party apparatus has effectively infiltrated many sources of effective power. They lead the principal labor syndicates, control many student groups, have officers in several ministries and have a few men in the Army, especially at the sergeant level.

This is roughly the setting. It is an ideal one for an extreme right or leftist coup.

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This would be the end of freedom in Brazil for years to come. If it comes, it is unlikely that there will be a mass popular opposition. Most people are fed up with the present political scenery.

This is no prediction on our part that a coup will take place. As we shall note later on in this report, some powerful democratic forces are beginning to exert themselves. But we heard from many well-informed sources that this is indeed a possibility. Democratic forces in Brazil deem it urgent to find means to prevent an unconstitutional solution before October. As Governor Carlos Lacerda told us, "The important thing is to get to the October elections. They will clear the atmosphere."

Exactly how the October elections will settle the present lack of a purposeful and decisive government is not entirely clear to us. Especially so since Goulart would continue in the Presidency. Most Brazilians are of the opinion, however, that the political abnormality created by Quadre's resignation will be remedied.

Brazil's Importance to the United States

Brazil is of paramount importance to the United States. With half the territory of Latin America, a population variedly estimated at between 70 to 75 million, huge natural resources, a variety of climates -it is potentially a world power to be reckoned with.

President Kennedy's statement "The Cold War will not be won in Latin America but it may well be lost there", certainly applies to this large and complex nation. If the Communists ever take a hold of this country, the United States' position in Latin America may well be doomed. She borders every South American State, except for Chile and Ecuador. It would be a gigantic base for subversion of its smaller sister republics.

Our stakes in Brazil are of such magnitude that we cannot permit this country to be lost to democracy. This should be a definite United States objective. We can ponder, we can question, we can engage in debate as to the means necessary to achieve this objective. But our purpose must be clear.

The Present Economic Picture

Brazil's economy is expanding rapidly despite the serious coffee problem, whatever the rampant inflation, notwithstanding the sad status of her financial affairs, and regardless of the recent political tensions. Brazil exceeds all other South American countries in terms of its economic annual growth rate.

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Brazil's Gross National Product, which represents 30% of overall South American production rose at an average annual rate of 5.2% during the 13 years to 1960; in real terms. Between 1955 and 1959, the yearly average rate was 6.3%. In 1960 it came to 6%, and in 1961, despite financial difficulties, to near 6%. The rate of expansion may have slowed down somewhat over the last 9 months in the wake of political events. Nevertheless, it is still notable.

Industrial production has more than doubled between 1955 and 1960, when the index (1955=100) averaged 214.

Many other facts and figures could be cited to show a generally rosy economic picture. It would seem that, if Brazil could only maintain its present rate of growth for another decade, most of its pressing economic problems would be solved. This seems to be precisely the issue. Brazil is a wild galloping horse that must be kept on the track.

What is wrong then with the present economic situation? It is not our purpose to analyze this question in detail here, but we would like to at least enumerate some of the key problems:

1. Political instability raises the question of whether the present expansionary course can be maintained. This instability, in turn, affects the investment climate.

2. Inflation has become a way of life in Brazil. The cost of living index (1953=100) has risen seven-fold during the past 8 years. Present estimates put it anywhere from 40 to 50 percent a year.

3. Increases in agricultural production have not kept pace with industrial production. Although no reliable figures exist, most well-informed Brazilians confirm this.

4. Economic growth has taken place almost exclusively in the South and South-Center regions. The Northeast's economy is almost as primitive as it was 50 years ago. This is an explosive social situation.

It seems evident that these and other problems must be solved if Brazil is to continue its present rate of economic expansion.

The Communist Menace

The Communists are an important part of the political picture. Even though nobody seems to have an even approximate idea of their numerical strength, most observers will agree that "real" communists are few. But they wield considerable influence by their effective infiltration of key positions of political and economic power.

This is a quick rundown of their relative strength in various fields:

1. Student unions are largely controlled by Communists and by their sympathizers. This is true throughout Brazil. The high school students are likewise influenced, but to a lesser extent. Actually, a minority of the students are Communists, but thru their activism, propoganda, deceit, and principally, thru the indifference of the majority, they control student elections.

2. The principal labor syndicates are likewise controlled by Communists and by their friends. As in the case of the students, a small organized minority controls the important elections. This process is helped by the considerable assistance received from important government leaders in the form of political jobs and influence.

3. The ministries, the important public corporations (autorquios), even the President's Office, are effectively infiltrated by some Communists.

4. The Armed Forces officer class is relatively free from infiltration. But we heard that some infiltration does exist amongst Army officers, and especially in the sergeant class.

5. The most incredible example we heard of Communist influence is the financial help granted by well-known Brazilian millionaires to Communist campaigns. Two specific names are the Mattarazo family in Sao Paulo and Moraes in Pernambuco. But there are others. Apparently the reason is black-mail. These financial interests are in effect paying the Communists for protection against labor strife.

In all these groups, and others, the Communists are spending huge sums of money. Reliable reports estimate these expenditures at approximately \$10 million a month.

The present Communist strategy seems to be to infiltrate key positions of power and to disrupt the economic system. The Communist strategy in this field follows several effective means:

1. Fostering inflationary measures.
2. Fostering nationalistic, anti-foreign (especially anti-U.S.) government policies (e.g. foreign remittance bill).
3. Nationalization of many private enterprises (oil production and refining, shipping, railroad, electricity production, telephones, etc.) which, when operated by the Federal Government, produce large operating deficits.

Brazil is a shining example of the Communist Party's efficacy in exerting wide influence and power with but a few adherents. Its importance would be insignificant if the large non-Communist majority got together to block its influence.

Suggestions on AID Policy

The present United States policy with regards to Goulart's administration seems to be one of cooperation. This may be the only practical alternative now open to us. It is fraught with dangers but it seems to be the lesser evil.

While maintaining this policy for the time being, it is important that we recognize the need to encourage a constructive democratic solution to the present political vacuum. This will not be easy, but we would like to submit for your consideration some specific suggestions:

1. It should be an unwritten policy to separate our friends from our foes.

We should set a policy of active and prompt cooperation for constructive friendly leaders, accord the red-tape treatment for the demagogic neutral leaders, and the "icy-cold" treatment for our enemies. In practice, this would mean that financial requests from groups, such as, C O P E G (Companhia Progresso do Estado da Guanabara), should get almost instantaneous approval, with the barest minimum of analysis. The same policy would hold for men such as Governor Juraci Magalhães of Bahia, Governor Cid Sampaio of Pernambuco and others. Most of these leaders are impatient with what former Finance Minister Clemente Mariani called "...excessive red-tape in the U. S. Embassy".

Projects submitted by such "neutrals" as Janio Quadros should get plenty of red-tape.

The "icy-cold" treatment would be reserved for men such as, Governor Leonel Brizola and Mayor Miguel Arrais of Recife.

The friends of democracy and of the U. S. showed considerable distress with what they alleged to be U. S. practice of bunching friends and foes together.

We are in no position to say whether this is true or not. If so, it would be a grievous fault and it should be corrected.

Perhaps, the political officers of the U. S. Embassy could classify in these 3 categories the principal 100 Brazilian leaders and the list could serve a useful purpose to the A.I.D. Program.

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2. It seems to us that the role of the Catholic Church in Brazilian Society has not been given sufficient recognition in our plans. The Catholic Church wields great influence amongst Brazilians of all social levels, and especially so amongst the rural workers. There are many indications that it is taking an increasingly important role in social change and in the anti-Communist fight. The Cardinal of Sao Paulo, for instance, is a most controversial figure for his advocacy of social and economic reform. So are some of the bishops of the Northeast. These are not isolated cases. We were told in the Northeast, that Francisco Juliao (who never had anywhere as much influence as has been reported in the U.S.) has lost considerable ground recently because of the aggressive tactics in the rural areas of Padre Melho and other priests.

Of special interest is the work conducted by Don Eugenio de Araujo Soles (Bishop of Natal) thru his Servicio de Asistencia Rural. Everyone we talked to in Rio Grande do Norte (including Governor Aluisio Alves) confirmed the efficacy of Don Eugenio's program. There is not a single Liga Camponesa in the State of Rio Grande do Norte (Don Eugenio's priests, however, have organized many rural labor syndicates.)

Don Eugenio's work follows generally the pattern of Monseñor Salcedo's Sutatenza Program in Colombia. It has over 25,000 regular students in its "Escuelas Radiofónicas". Don Eugenio has just been appointed to head the Secretariado del Nordeste, which will cover the whole Northeast. Eventually this program will be extended to all of Brazil.

Despite the touchy problems in the U. S. of Church-State relationships, ways must be found to assist the educational, reformist, anti-Communist efforts of this decisive force in Brazilian Society. We found much criticism amongst Brazilians of all shades of opinion and religious beliefs because the U. S. will not recognize the fact that "The Catholic Church is a reality of Brazilian Society".

3. The United States Government should encourage the process whereby U. S. companies integrate more with Brazil. We suggest that consideration be given to an amendment to the U. S. Tax Code granting a tax incentive on profits repatriated to the U. S., to those companies operating abroad which sell a certain percentage of their equity capital to nationals.

No amount of persuasion is going to attain this desirable goal. For a U. S. company operating in Brazil, there are obvious economic disadvantages to "...going public". But there is a clear political advantage to the United States if its companies operating abroad take nationals of the country as their business partners.

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By the way, everyone we talked to seemed to agree with the Kennedy-Goulart agreement on foreign utilities. To enlightened capitalists this means inefficient government operation with higher costs to Brazil; but politically they accept that it is the only answer. It is interesting to note here that a group of Brazilian businessmen, headed by Gilberto Huber, has submitted to Goulart a specific offer to purchase the telephone company. It is reported that Goulart has reacted sympathetically to the proposal. If the deal is consummated, it might prove a fine precedent.

We found much criticism in Brazil of U. S. companies. Much more so than in Colombia. The nationalistic fever there is running high.

4. We found considerable criticism in many quarters with the slow consideration by the AID program of financial requests. The need to prepare economic feasibility studies, detailed plans and specifications, justifications in English, etc. seemed to tax the patience of government and private leaders. This, plus the delays between the Rio and Washington offices of AID. Some Brazilians insisted that the funds should be authorized, transferred and that they should be allowed to spend it.

Of course, this is not possible. Besides, we can readily understand the need for proper justification of each individual project, the fantastic administrative task involved in the consideration by AID of hundreds of requests from the 20 Latin-American republics, and the difficulties in organizing a program so large and complex.

It is evident, however, that Brazilians are going to submit an increasing number of applications in the near future. It seems to us that the project analysis staff in Rio must be strengthened and that a greater decentralization of decisions is a must.

5. The Sudene Program for the Northeast is the one single program which has been allotted the largest share of AID funds (excluding the Stabilization Fund.) Therefore, it is proper that we discuss it at length. We talked to more people in Rio, Sao Paulo, and the Northeast, about Sudene than about any other single issue. This is a resumé of our impressions:

a) The need for an organization and for a regional program such as Sudene's is unanimously accepted. It is readily recognized that the small states of the Northeast-with their inadequate budgets, their corruption, their petty politics, their incompetence-could never plan and execute an effective Regional Plan.

b) Sudene's enabling legislation is also generally accepted as sound.

c) There is not the same kind of unanimity with regards to the efficacy of Sudene's work. Some persons interviewed allege that Sudene spends all of its money and effort planning and "...doesn't do anything". This criticism is stronger in Rio and Sao Paulo than in the Northeast.

We had an interview with Dr. Celso Furtado. He impressed us as a competent economist, an effective leader, with plenty of drive. From what can be surmised in the course of a conversation, his planning for the "economic infrastructure of the Northeast" seems to make sense. We must point out, however, that both Ambassador Bohan's "Northeast Brazil Survey Team Report" of February 1962 and Sudene's present activities, are woefully inadequate in their provisions for effective agricultural development activities. Thru the application of modern agricultural techniques food production in the Northeast can be multiplied many times. Besides, we saw plenty of good agricultural land completely uncultivated.

d) The really controversial aspect of Sudene is Dr. Celso Furtado himself and some of his principal collaborators. Some people accuse them of being Communists. Most of the others assured us that they were "Marxist-oriented". Ambassador Lincoln Gordon stated that Furtado was definitely a Communist until 1957 or 1958 and that he is not certain of his present ideological position, although he (Gordon) believes that he is not now a Communist. Dr. Jorge Oscar de Mello Flores, President of Banco Hipotecario Lo Brasileiro and of Sud America Capitalizacao, assured us that as head of the Getulio Vargas Statistical Institute, he fired Celso Furtado several years ago when he discovered that he was a Communist.

The controversy over Dr. Furtado's ideological position is a hot issue. Many people claim that many of his principal collaborators are known Communists. We are attaching to this Report a recent article by Dr. Furtado which he asked us to remit to Mr. Moscoso. It is interesting to note that the article does not: 1.) mention the United States; 2.) mention the Alliance for Progress, much less credit it with providing Sudene with substantial help; 3.) take a clear anti-Communist stand.

We are in no position to state where Dr. Celso Furtado's present ideological allegiance may rest. Much less that of his principal technical collaborators. But he deserves very close observation.

It seems to us that the Biblical advice "By their acts so ye shall judge them" is most applicable to Dr. Furtado. We must judge him by his actions towards the private sector of the economy in the Northeast.

To practically every businessman who showed fear of Dr. Furtado's ideological allegiance, we recommended that they develop concrete projects for private agricultural development in the Northeast. Sudene must act upon these projects by: a) extending electric power lines and other

public services; and b) granting the various tax incentives provided for in the Sudene Act. If Dr. Furtado blocks, or obstructs, these specific projects, the political issue would have to be met.

It would have to be met by the Brazilian Government and by the Alliance for Progress. The sooner we find out, the better it will be for everyone concerned.

It is encouraging to note that many businessmen told us of their plans to expand to the Northeast. Many of these businessmen are from Sao Paulo and Rio and they are sincerely concerned with the explosive political situation in that area.

We would like to recommend that the AID mission in Rio and Washington give a top priority to the consideration of requests for private projects from the Northeast.

6. The word "reform" is applied to almost every program in Brazil. It is a good political word. It seems to us, however, that the most important of all is "administrative reform"; and probably the most difficult. Without a thorough public administration reform, the public sector's contribution to Brazilian progress is bound to be inadequate. Second in importance is tax reform. The tax system in Brazil is archaic, regressive and enforcement is weak. The State governments' principal source of income is sales taxes. From producer to consumer, the sales tax is sometimes collected 8 or 10 times, depending on the number of intermediaries.

I cannot get too excited with agrarian reform in Brazil as a whole. There are undoubtedly some spots in the Northeast and elsewhere where land distribution may be desirable. But in a country the size of Brazil, where most of the arable land is not being cultivated, there is no pressing "economic need". In certain areas, however, there may be a "political need". Great care should be taken, however, to see that production is not affected. The real agricultural problem of Brazil is to rationalize production, thereby increasing present income many times.

7. It seems to me that the Alliance for Progress would be wasting its ammunition if it uses its resources principally to build housing projects, school classrooms, hospitals, etc. Perhaps, a small proportion of the funds should be allotted to these purposes. But the basic solution to these pressing social needs must come from Brazilians themselves. Even if we allotted \$3 billion a year for 5 years, we would be barely touching the surface of the problem. The needs are that large.

We should devote funds principally to the stimulation of projects in sensitive areas with potentially multiplier effects. Projects, such as a Brazilian public relations program in support of the Alliance for Progress; Don Eugenio's Sociedad de Asistencia Rural in the Northeast;

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financial support to private model farms in the Northeast and other agricultural areas of Brazil; technical assistance in various fields, such as industrial and agricultural productivity, education, health, and others; financial assistance to basic industries, such as Dr. Paulo Ferraz's salt project in the Macao district of Rio Grande do Norte.

8. We were informed that the AID program will defray half of the expenses of any economic feasibility survey, but only for U. S. firms. Perhaps, it would be advisable to extend this same financial cooperation to Brazilians, and nationals of other countries. The need for "levantamientos" (surveys) is urgent. Since the technicians are usually from the States or Europeans and must be paid in hard currencies, this becomes a substantial item of expense.

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