

TELEGRAM

INCOMING

AMEMBASSY BRASILIA

Foreign Service of the
United States of America

POI-1 USG: BRAZIL

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O R 061925Z JAN 69
FM AMEMBASSY RIO DE JANEIRO
TO RUEHC/SECSTATE WASHDC IMMEDIATE 6198
INFO RUESUP/AMCON SAO PAULO 2284
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STATE GRNC
BT
SECRET RIO DE JANEIRO 085

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SUBJECT: REACTION TO WITHHOLDING \$50 MILLION TRANCHE
1. BECAUSE SIZE OF AND PREVIOUS COMMITMENT ON \$50 MILLION
TRANCHE RELEASE GIVES IT SPECIAL POLITICAL SIGNIFICANCE,
I STRONGLY URGE THAT DECISION ON TIMING OF TRANCHE RELEASE BE
MADE IN CONTEXT OF OVERALL U.S. POLICY OBJECTIVES AND TACTICS.
BELTON AND KLEINE NOW IN WASHINGTON FOR THIS PURPOSE. FOR THIS
REASON, I CONSIDER QUESTION IN REFTEL
SOMEWHAT PREMATURE. UNLESS SITUATION DETERIORATES DRASTICALLY,
WE APPEAR TO HAVE NO LEGAL BASIS FOR WITHHOLDING TRANCHE INDEFINITELY.
TIMING OF RELEASE MUST STRIKE DELEGATE BALANCE BETWEEN RISKS
OF (A) GIVING GOB IMPRESSION OF US COMPLACENCY ABOUT
IA -5 AND (B) RAISING QUESTION OF CRRDIBILITY US FULFILLMENT
OBLIGATION. ANOTHER IMPORTANT FACTOR TO BE CONSIDERED IS THAT
GOB WILL INEVITABLY USE REALESSE FOR PROPAGANDA EFFECT AS EVIDENCE
OF US SUPPORT, REGARDLESS OF TIMING OR OF PRECUATIONS WE MAY
TAKE.

2. FOLLOWING RESPONSES ARE KEYED TO SPECIFIC QUESTIONS REFTEL:
A. PRIVATE SECTOR REACTION.

1. IF US WITHHOLDS \$50 MILLION TRANCHE FOR PROTRACTED
PERIOD, E.G., MORE THAN ONE ADDITIONAL MONTH, IT WILL BECOME
WIDELY KNOWN IN THE US AND BRAZILIAN BUSINESS COMMUNITY.
THERE ARE LARGE NUMBER OF IMPORTANT FIRMS WHO USE PROGRAM LOAN
FINANCING AND THESE FIRMS HAVE ALREADY BEEN WAITING FOR THREE MONTHS
FOR NEW FUNDS TO BECOME AVAILABLE. IN EYES OF PRIVATE SECTOR,
PROTRACTED WITHHOLDING OF TRANCHE WILL HAVE GREATER IMPACT AND
POLITICAL SIGNIFICANCE THAN DELAY IN OTHER TYPES OF AID. UNDOUBTEDLY
MAJORITY OF US BUSINESS COMMUNITY WILL BE UNHAPPY, GIVEN
ITS FEAR THAT ANY ADVERSE REACTION BY USG TO IA-5 MIGHT ADVERSELY
AFFECT ITS INTERESTS HERE.

2. IT IS DIFFICULT TO PREDICT, HOWEVER, WHAT EFFECT WOULD
BE ON BUSINESS CONFIDENCE. WE DOUBT THAT PRIVATE SECTOR REGARDS

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\$50 MILLION TRANCHE BY ITSELF AS SPELLING THE DIFFERENCE BETWEEN SUCCESS OR FAILURE OF GOB ECONOMIC PROGRAMS. HOWEVER, IF PRIVATE SECTOR INTERPRETS WITHHOLDING OF TRANCHE AS INDICATION OF SIGNIFICANT REDUCTION IN US SUPPORT OF GOB, FINANCIAL AND OTHERWISE, IT MIGHT WELL ADVERSELY AFFECT BUSINESS CONFIDENCE. THIS WOULD BE PARTICULARLY TRUE IF US AND EUROPEAN PRIVATE FINANCIAL SOURCES ALSO TOOK A MORE CAUTIOUS POSITION. EVEN SO, PRIVATE SECTOR MIGHT NOT ENGAGE IN SIGNIFICANT AMOUNT OF EXCHANGE SPECULATION, PARTLY DUE TO ITS REDUCES ABILITY TO DO SO GIVEN THE AUGUST EXCHANGE RATE POLICY AND CURRENT TIGHT CREDIT CONDITIONS BUT ALSO DUE TO ITS FEAR OF GOVERNMENT REPRISALS. NEVERTHELESS, POSSIBILITY OF SPECULATION CERTAINLY EXISTS.

B. GOB POLICIES IN FACE OF EXCHANGE SPECULATION.

GOB MUCH MORE LIKELY TO USE IMPORT RESTRICTIONS TO COMBAT EXCHANGE SPECULATIONS BEFORE RESORTING TO EXCHANGE CONTROLS, BECAUSE LATTER RUN SO DIRECTLY COUNTER TO GOB'S ECONOMIC PHILOSOPHY AND ALSO CONTROLS WOULD BE A SIGN OF GOVERNMENT WEAKNESS, IF NOT PANIC. ON THE OTHER HAND, THERE ALWAYS EXISTS STRONG PRESSURE FOR IMPORT RESTRICTIONS, SINCE BRAZILIAN PRIVATE SECTOR OVERWHELMINGLY ORIENTED TOWARD SHELTERED INTERNAL MARKET. IN FACT, WE HAVE ALREADY SEEN IN PAST FEW DAYS SUCH MEASURES IN FORM TARIFF INCREASES ON "LUXURY" GOODS.

C. EFFECT ON FIANCE MINISTER.

WE RECOGNIZE PROTRACTED DELAY OF TRANCHE COULD WEAKEN POSITION OF FIANANCE MINISTER WITHIN GOVERNMENT. ALTHOUGH WE DO NOT WISH TO EXAGGERATE IMPORTANCE OF US AID IN THIS REGARD, PART OF HIS STRENGTH UNDOUBTEDLY LIES IN HIS ABILITY TO DELIVER SIGNIFICANT AMOUNTS US AND OTHER FOREIGN AID.

D. EVEN MORE IMPORTANT THAN EFFECT ON DELFIM PERSONALLY

OF DELAY ON TRANCHE IS ITS EFFECT ON GOB POLICIES. IN THIS REGARD, FOLLOWING CONSIDERATIONS APPLY:

1. THERE IS SIGNIFICANT LATENT XENOPHOBIA AMONG HARD-LINE MILITARY. THESE VIEWS MIGHT BE STRENGTHENED IF IT APPEARED THAT US WAS REACTING TO IA-5 BY CUTTING DOWN AID. THIS MIGHT MAKE IT MORE DIFFICULT FOR THOSE MINISTERS, CHIEFLY DELFIM AND MACEDO SOARES, WHO RECOGNIZE IMPORTANCE OF FOREIGN INVESTMENT TO BRAZILIAN DEVELOPMENT, TO RESIST THOSE WHO WISH TO REDUCE FOREIGN PRESENCE HERE. OF COURSE, WE CANNOT LET OUR POLICIES BE ENTIRELY SHAPED BY FEAR OF SUCH REPRISALS; HOWEVER, IF THERE IS TO BE A SIGNIFICANT CHANGE IN THE NATURE OF OUR AID PROGRAM HERE, SUCH RISKS MUST BE TAKEN INTO ACCOUNT.

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2. ON THE OTHER HAND, AS EVENTS UNFOLD, IT IS ENTIRELY POSSIBLE THAT DISCREET US POSTURE MIGHT SERVE TO STRENGTHEN HANDS OF THOSE BRAZILIANS (INSIDE AND OUTSIDE OF GOVERNMENT) WHO ARE ATTEMPTING INDUCE COSTA E SILVA DIRECTION OF REESTABLISHMENT BASIC DEMOCRATIC ORIENTATION.

3. IMPLICATION FOREGOING IS THAT WE CANNOT AT THIS POINT PREDICT EXACTLY WHEN TRANCHE SHOULD BE RELEASED FOR OPTIMAL EFFECT ON GOB. EMBASSY WILL CONTINUE TO ASSESS SITUATION ON DAILY BASIS, RECOGNIZING OF COURSE THAT WE WILL HAVE TO MAKE A DEFINIATE DECISION ON TRANCHE IN NEAR FUTURE. TUTHILL
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