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THE FINANCIAL CRISIS IN BRAZIL

Submitted by the
DIRECTOR OF CENTRAL INTELLIGENCE

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Concurred in by the
UNITED STATES INTELLIGENCE BOARD

on 21 July 1959. Concurring were the Director of Intelligence and Research, Department of State; the Assistant Chief of Staff for Intelligence, Department of the Army; the Assistant Chief of Naval Operations for Intelligence, Department of the Navy; the Assistant Chief of Staff, Intelligence, USAF; the Director for Intelligence, The Joint Staff; the Assistant to the Secretary of Defense, Special Operations; and the Director of the National Security Agency. The Atomic Energy Commission Representative to the USIB, and the Assistant Director, Federal Bureau of Investigation, abstained, the subject being outside of their jurisdiction.

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THE FINANCIAL CRISIS IN BRAZIL

THE PROBLEM

To estimate the political and economic consequences of the Brazilian financial crisis, over the next few months.

THE ESTIMATE

I. THE CURRENT SITUATION

1. Brazil is in a financial crisis. During the next five months, in addition to normal current payments for imports, Brazil is obligated to pay \$140 million in principal and interest on its foreign debt, which totals over \$2.2 billion. (Of this total, about three-fifths is accumulated commercial indebtedness.) As of mid-July, Brazil's current dollar exchange availabilities were down to about \$26 million; its uncommitted gold reserve was about \$70 million.¹ Moreover, foreign exchange income during the rest of 1959 will be low, since the bulk of payments for coffee exports will not be received until after the first of the year. Finally, Brazil has stretched its credit close to the limit. In these circumstances, unless Brazil obtains US assistance or a moratorium on its debt payments, it will be forced to default.

2. The present financial crisis in Brazil is a repetition of similar crises in the postwar period. A primary source of these difficulties has been Brazil's effort to sustain a high rate of economic development in the face of de-

clining foreign earnings—Brazilian GNP increased at an average annual rate of about six percent in the period 1946 through 1954, and at a rate of about four percent in 1955 through 1958. About 1955, however, the price of coffee began to fall, and with it the value of Brazilian exports. To maintain the high rate of imports necessary for development, Brazil has drawn down its foreign exchange reserves and has borrowed large amounts on short and medium term arrangements. Its financial position has been weakened further by the failure of successive Brazilian governments to control inflation. Prices have nearly trebled since 1953. Major causes of the inflation have been large-scale deficit spending by the government² and a continuing rapid expansion of private credit—the Brazilian money supply almost tripled from 1953 to the end of 1958. There is little hope for improvement in this situation, at least through 1960—Brazil's balance of payments deficit will run at about \$300 million per annum in 1959 and 1960, a rate comparable to that in 1958. The bill for servicing foreign debts will continue to be a major cause of this deficit; in 1960 it will be about \$350 million.

¹ A portion of this reserve must be considered to be potentially committed in that Brazil has agreed to increase its contribution to the International Monetary Fund and to provide its share of the capital of the newly-created Inter-American Development Bank.

² The internal debt of the federal government is roughly estimated to be 100-125 billion cruzeiros (i.e., roughly \$700-860 million at the current free rate of exchange).

3. In 1958, in a similar situation, Brazil asked the US for balance of payments assistance. The US granted this request, but only after Brazil had agreed to adopt a stabilization program acceptable to the International Monetary Fund (IMF). The US has followed a similar course of action with respect to other Latin American countries, including Argentina, Chile, Peru, and Bolivia. However, because of domestic political pressures, President Kubitschek was unwilling fully to implement the stabilization program. In January of this year Brazil again indicated that it required US assistance in financing a prospective 1959 balance of payments deficit of over \$300 million, and again Brazil was told first to develop a stabilization program with the IMF.

4. At the present time negotiations between the IMF and Brazil have been broken off, primarily because President Kubitschek is unwilling to reduce subsidies on certain essential imports, especially petroleum, petroleum products, and wheat. He argues that such action would substantially increase the cost of living, and that this would cause widespread unrest and internal strife. He is almost certainly apprehensive of the effect these developments might have on his party's prospects in the October 1960 elections.

5. The resolution of the disagreement between President Kubitschek and the IMF is made extremely difficult because of a basic difference in philosophy. He is committed to rapid economic development, as well as to the building of the new capital city, Brasilia. In view of the shortage of domestic capital, most of the leaders in his government believe such development can be accomplished only by large-scale deficit financing through the national budget and by an easy credit policy.

6. The Brazilian Government has now asked for US assistance in the absence of an agreement with the IMF. President Kubitschek almost certainly is counting on the US relenting somewhat and being willing either to put enough pressure on the IMF to cause it to modify its position or, in the end, coming to Brazil's assistance without an IMF agree-

ment. He probably believes that the US, apprehensive regarding the security of US military rights and US investments in Brazil (about \$1,000 million), will act as he desires, lest a continuation of the impasse open the floodgates of ultranationalism and anti-Americanism. He appears to believe these considerations will outweigh US reluctance to make an exception to the IMF stabilization program approach.

7. In the following paragraphs we estimate the consequences of the Brazilian financial crisis, over the next few months, if: (a) Brazil refuses to meet IMF conditions and receives no stabilization assistance from the US; (b) Brazil refuses to meet the IMF requirements, but the US agrees to reschedule debt repayment; and (c) Brazil agrees to meet the IMF requirements and receives additional assistance from the US.

II. CONSEQUENCES OVER THE NEXT FEW MONTHS

Assumption A: Brazil refuses to meet the IMF requirement and receives no stabilization assistance from the US.

8. *Economic Prospects.* Even under these circumstances, Brazil could probably avoid default for the next few months. It has already obtained a \$50-million credit from the Federal Reserve Bank of New York, using part of its gold reserve as collateral, but on a disappointingly short 60-day term. It can probably negotiate the rescheduling of some of its commercial debts. Moreover, Brazil might be able to maintain roughly the current level of its two largest and most costly imports, petroleum and wheat. Foreign petroleum companies would probably be willing to extend further credits in order to maintain their share of the Brazilian market. Despite the US position on the stabilization problem, Brazil might obtain additional PL 480 wheat shipments. Furthermore, while European countries (West Germany, France) have recently indicated that they are unwilling to discuss Brazil's debt problem until Brazil has reached an agreement with the IMF, it is probable that some European credits will be obtained.

9. However, these measures would only be palliatives. Brazil would have to cut its imports sharply, an action which would adversely affect many important projects and which would give a boost to already critical inflationary pressures. Moreover, before the end of the year Brazil would almost certainly have to default on some of its foreign debts.

10. *Political Prospects.* In the short run, Kubitschek could probably avoid much of the onus for the deteriorating economic conditions by blaming everything on the US. He would charge that the US, under cover of the IMF stabilization agreement, had sought to interfere in Brazil's internal affairs, and he would assert that he had acted to defend Brazilian national sovereignty. The major effect of the deteriorating economic situation on the campaign for the 1960 elections, which has already begun, would be to increase both the shrillness of the anti-American speeches and the number of politicians making them. By the end of the year, the economic situation would have so deteriorated that serious civil disturbances would be likely. It is probable that the military could and would sustain the government in these circumstances, pending the 1960 elections. However, if they came to conclude that order could not be maintained without a change of administration, the military, as in 1955, might call upon the president to resign and install a caretaker regime to conduct the elections.

11. *Brazil's Attitude Toward the US.* It is possible that, if Kubitschek concluded that the US would not relent on its conditions for assistance, he would come to terms before the situation had deteriorated too far. He would, of course, seek to present any agreement as a political success rather than as a capitulation. It is more likely that he would maintain his position and institute a series of retaliatory actions, including perhaps the blocking of remittances by US concerns and the expropriation of some US holdings. He might even come to abrogate US military rights. Such actions are among those included in a so-called "disaster plan" which has apparently been formulated by certain of Kubitschek's more radical advisors. In the

assumed circumstances, they would probably have wide popular support. But at the same time there would probably be many elements of the business community, the military, and the government that would oppose jeopardizing seriously Brazil's relations with the US. We believe it unlikely that any Brazilian government could long sustain an anti-US policy like that of Argentina under Peron.

12. *Brazil's Attitude Toward the Soviet Union.* Kubitschek would be under heavy pressure to seek assistance from the Soviet Union. At the same time, there would be opposition to such action by conservative groups, especially by the military. Nevertheless, if there were no amelioration of economic conditions within the year and if the Soviet Union volunteered substantial assistance, it is probable that Brazil would accept. While Brazil's leaders are fully aware of the importance of their economic relations with the US, in the assumed situation they would probably feel that, even though the US would be displeased, they had no choice but to accept Soviet aid.³ They would also believe that such action would bring pressure on the US to reconsider its position.

13. *The Attitudes of Other Latin American Countries.* Latin American opinion makes no distinction between the US and the IMF. There would probably be widespread popular sympathy for Brazil in its stand against "dollar imperialism." Initial comment in those countries which have accepted IMF stabilization requirements has been to the effect that Kubitschek's rejection of such terms has proved that their governments need not have surrendered to IMF dictation. On the other hand, the governments which have obtained US assistance by accepting IMF stabilization requirements must, in self-justification, support the US position and, indeed, insist that Brazil be made to comply with the same requirements which they have met at considerable political cost to themselves.

³ Soviet assistance could not do much to ease Brazil's current crisis unless the Soviet Union were willing to grant some balance of payments credits or to supply a major portion of Brazil's petroleum requirements on a credit basis.

Popular understanding and acceptance of this point of view would tend to increase if economic conditions in the cooperating countries actually improve while those in Brazil deteriorate. Nevertheless, nationalistic and anti-US extremists throughout Latin America, especially those under Communist influence or control, would continue to denounce the US for intervention in the internal affairs of Brazil through dollar diplomacy and to call for united Latin American support for the Brazilian position.

Assumption B: Brazil refuses to meet IMF requirements, but the US agrees to reschedule debt repayment.

14. *Economic Prospects.* Under these conditions, Brazil could probably limp through the next 18 months. It would probably avoid debt default, but, unless Kubitschek took actions on his own further to reduce imports and to expand exports, Brazil at the end of 1960 would almost certainly be faced with a crisis similar to the present one. Internally, inflationary pressure would almost certainly continue and the price of bread and petroleum would increase—the very thing Kubitschek has sought to avoid in refusing to accept IMF conditions.

15. *Political Prospects.* Kubitschek would be able to squeeze some favorable publicity out of what he would claim to be a successful defense of Brazilian sovereignty. However, unless he takes major action toward establishing a greater degree of internal economic equilibrium, a course which is unlikely, he and his party will become increasingly vulnerable to charges of economic mismanagement. It is possible that this could become a decisive factor in the 1960 elections.

16. *Effect on Brazil's Attitude Toward the US and the Soviet Union; on the Attitude of Other Latin American Countries.* US-Brazilian relations would probably not be significantly affected in the short run; however, as the economic difficulties continued there would probably be an increase in Brazilian irritation with the US because of its failure to be more generous. While it is likely that

Brazil would at any time accept from the Soviet Union assistance which Brazil considered useful, under the assumed conditions Brazil would almost certainly scrutinize possible Soviet offers more closely than it would under Assumption A. In most other countries of Latin America, there would be a tendency to admire the success of the Brazilian action against the US effort to impose distasteful conditions. However, in the countries now operating under IMF arrangements the governments could probably defend their own actions by pointing out how much more assistance they obtained than did Kubitschek.

Assumption C: Brazil makes an agreement with the IMF and receives assistance from the US.

17. *Economic Prospects.* There would be some improvement in Brazil's economic outlook. If the changes within the Brazilian economy are for the most part gradually imposed, the reaction to any austerity measures would probably be mitigated. Kubitschek would probably not press vigorously measures designed to curtail credit, to reduce deficit financing, or to act substantially to raise prices of basic items such as bread, petroleum products, or transportation—all of which, because of subsidy arrangement, are major burdens on the national budget. Generally speaking, we believe it likely that under the assumed conditions Brazil would maintain through 1960 a rate of growth of GNP of about four percent. Inflation would have been curtailed somewhat, and exports might show some improvement. But Brazil would almost certainly still require external assistance, including balance of payments support, in 1961.

18. *Political Prospects.* Regardless of the facts, the Brazilian Government would believe it essential to present the IMF agreement as a victory for Kubitschek. Provided no serious economic crisis developed before the elections, Kubitschek's party would probably make a net gain from an agreement with the Fund and receipt of US aid. However, if economic conditions should deteriorate, he would at-

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tempt to place the full blame on "inadequate" assistance from the IMF and the US.

19. *Effect on Brazil's Attitude Toward the US and the Soviet Union.* Brazil's relations with the US would continue to be basically friendly, although the charge that conditions had been imposed by the US would add fuel to the anti-American campaign, which is already strong and will increase during the election period. While Brazil would be under less pressure to accept Soviet offers of assistance, it would probably still accept at any time an offer which it considered favorable.

20. *Effect on the Attitude of Other Latin American Countries.* If Brazil should reach an agreement with the IMF, the result would be to eliminate Brazil as a rallying point in Latin America for agitation against US-IMF stabilization programs. It would also tend to reduce criticism in other Latin American countries of their own stabilization programs. However, should the other governments come to believe Brazil had gotten a better deal than they had, some would be likely to press for an easing of the conditions of their own agreements.

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