Brazil:

Domestic, Financial and Foreign Affairs Briefing

10.12.2012

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Domestic Briefing
Brazil: Forever the Country of Tomorrow

"Brazil is the country of tomorrow and always will be," declares a popular Brazilian phrase. For decades, the Giant of Latin America has struggled to meet its lofty potential. Of particular frustration to Brazilians, the major hindrances to development have been the same for decades, if not centuries. Issues related to education, infrastructure and corruption have long plagued Brazil yet solutions remain elusive. Why, Brazilian's wonder, do the same issues persist year after year?

At various points, Brazil has attempted to rectify long standing deficiencies with rapid development programs. For example, under military rule (1964 – 1985), Brazil followed an Import Substitution Industrialization strategy which sought to overcome a century of industrial neglect within a few years. Such 'short-cut' solutions severely distorted the Brazilian economy and led to unsustainable debt and, eventually, hyperinflation in the early 1990s.

Given the barriers that education, infrastructure and corruption deficiencies place on Brazilian development, it is worth addressing these issues individually.

Education

The seeds of Brazil's longstanding education deficit were sewn centuries ago under colonial rule. The Portuguese monarchy did not value education, and the Catholic Church did not finance learning institutions in Brazil as it did in the Spanish colonies. Furthermore the agricultural elite that emerged in Brazil did not place a premium on education, and thus, did not push for its development.

With a modern public school system based on this deep-seated inattention, Brazilian primary institutions have struggled to prepare students either to enter the work force or to move on to higher education. Two-thirds of Brazilian teens can do little more than menial mathematics, while 10% remain illiterate. Primary education expectations can differ widely across race and region: White Brazilians average over eight years of education, while Black students average six. Regionally, students from the southeast average over seven years of primary education, while those in the poorer northeast average just five.

Given the inconsistencies of Brazilian primary schools, it is little wonder that the country's higher education struggles with attrition and inequality. The best universities in Brazil are public and free. This system generates a regressive subsidy as it is richer students who attended private primary institutions that tend to win spots in the best public universities, which they then attend on the state's dime.

PISA 2003: Percentage of students at bottom and top proficiency levels on the Mathematics scale. Selected countries.

Country	Level 1 or below	Level 2 or below	Level 5 or above
Canada	10.1	28.4	20.3
Spain	23.0	47.7	7.9
OECD average	25.6	46.8	13.1
USA	25.7	49.6	10.0
Portugal	30.1	57.2	5.4
Italy	31.9	56.6	7.0
Greece	39.0	65.3	4.0
Uruguay	48.1	72.3	2.8
Turkey	52.3	74.4	5.5
Mexico	66.0	86.8	0.4
Brazil	***75.2***	***89.3***	***1.2***

Source: OECD (2004a).

Brazilian students particularly underperform in mathematically related subjects

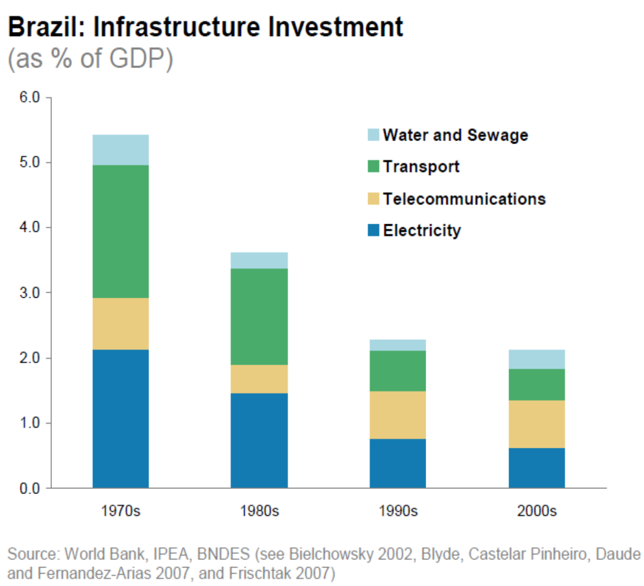
Overall only 11% of the working-age population has a university degree. Many students that begin university find themselves under prepared for the coursework or economically insolvent and they do not graduate. Of those that do, few pursue the scientific degrees required to forward Brazilian industrialization. In 2008, roughly 5% of university graduates earned engineering degrees while only 5% more completed mathematic degrees.

Presidents Fernando Henrique Cardoso (1995 – 2002), Luiz Inácio Lula da Silva (2003-2011) and Dilma Rousseff (2011 -) have all made efforts to improve education. Cardoso raised teacher's salaries and he increased public school funding. Lula's cash transfer programs were conditional upon classroom attendance, while his one-laptop-per-child program familiarized Brazilian youth with technology. President Dilma has extended teacher trainings and invested in vocational schools, especially in the underdeveloped northeast. Both Lula and Dilma have supported quotas for Brazilian youth of African descent.

Infrastructure

Infrastructure deficiencies cost Brazilian businesses billions of dollars annually. Mega-businessman Eike Batista sums up the problem neatly, "Land your cargo at a port and it may stay there in a container for 30 to 60 days."[1]

Brazilian fields produce grain twice as fast as the rest of the world, but getting that grain to port across unpaved roads can cost almost half its value, reports Reuters. Meanwhile vast mineral deposits remain buried deep within the earth for want of railroads to transport the goods.



Statistics support these anecdotes. A 2010 Morgan Stanley Blue Paper determined that Brazilian infrastructure investment has been on a consistent decline, from 5.4% of GDP in the 1970s all the way down to 2.1% in the 2000s – only slightly above the estimated 2.0% required to simply maintain the existing infrastructure stock.[2] Despite recently assuming the mantle as the world's 6th largest economy, the 2011-2012 World Economic Competitiveness Report found Brazil to rank 64th globally in infrastructure.[3]

[1] Shasta Darlington. "Brazil's Richest Man Build Huge Port." *CNN World*, 10/21/2010. Available online http://articles.cnn.com/2010-10-21/world/brazil.port_1_lula-da-brazilian-coast-richest-man?_s=PM:WORLD

[2] Guilherme Paiva. "Brazil Infrastructure: Paving the Way." *Morgan Stanley Blue Paper*, 5/5/2010, Pg. 3. Available online at http://www.morganstanley.com/views/perspectives/pavingtheway.pdf

International private sector investment has been underwhelming – something that analysts at both the World Bank and the United States Department of the Treasury struggle to explain given the potential financial rewards. Developers appear to be discouraged by a convoluted bidding process riddled with inevitable courtroom delays that can easily freeze a construction project for 6 to 12 months. OECD-based firms report concerns that insider knowledge and connections are required to work in Brazil, as well as a willingness to engage in corruption.

Corruption

A culture of corruption is deeply ingrained in Brazilian politics, and given the close ties of the government to state-owned-businesses such as PETROBRAS, that corruption can easily seep into Brazilian business.

The *Partido dos Trabalhadores* (The PT, or Worker's Party in English, is the party of President Lula and Dilma) may be relatively strong, but Brazilian political parties are historically weak, and rely on fickle coalitions. Politicians routinely jump ship from coalition to coalition and from party to party. As a result, Brazilian coalition builders have historically relied on 'deal-sweeteners' to induce participation.

Due to the effectiveness of his reforms, former President Lula remains very popular in Brazil. However, Lula's staff built the coalitions required to pass his reforms through monthly bribery payouts, now referred to infamously as *mensalão*. Without these payouts, Lula's reforms likely would not have come to fruition. In fact, little precedent exists for building coalitions without kickbacks, so generating and executing a long term national strategy without corruption appears very difficult.

A 2011 photo of President Lula with Former Minister of the Civil Cabinet Jose Dirceu. On 10/9/2012, Dirceu was found guilty of participating in *mensalão*.

The culture of corruption has important economic consequences as OECD private-sector firms have been reluctant to invest in Brazilian infrastructure projects because they do not want to assume the implicit costs.

President Dilma has attempted to address this ingrained corruption, removing numerous cabinet members (five in 2011 alone) for corruption charges. Much to the shock of Brazilians, in October 2012, the Supreme Court arrived at a number of guilty verdicts regarding the 2005 *mensalão* case that could result in prison sentences for prominent politicians and businessmen.

The Country of Tomorrow Today

The three most recent Brazilian presidents have attempted to conquer thorny development issues in stages. Faced with a country traumatized by inflation, President Fernando Henrique Cardoso (1995 – 2002) delivered macroeconomic stability through his Plan Real that mixed orthodox and heterodox strategies to slay hyperinflation. Without macroeconomic stability, President Luiz Inácio Lula (2003-2011) would not have been able to combine and improve

[3] Klaus Schwab. *The Global Competitiveness Report*. World Economic Forum, 2011, Pg. 126.

Cardoso's inchoate conditional cash transfer programs into *Bolsa Familia*, a form of financial aid that delivers cash to poor families that meet certain requirements such as child attendance in schools.

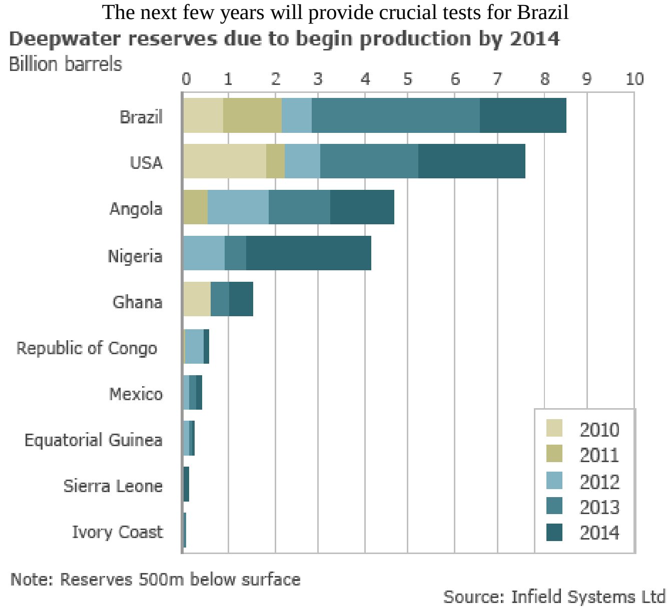
While some criticize *Bolsa* as a handout, its effectiveness cannot be questioned. Absolute poverty dropped nearly 20% from 2003 to 2005 (the first years of the program), compared to only a 2.2% drop in the final Cardoso years. Overall, *Bolsa* has lifted tens of millions of families out of poverty. Under Lulu, the Gini coefficient[4], regrettably high to begin with in Brazil, dropped to its lowest point since 1981.

Perhaps, if President Cardoso stabilized the economy, and President Lula brought millions of families into the middle class, now President Dilma Rousseff (2011 -) can address the longstanding issues of infrastructure, education, and corruption. While such a task will be daunting, President Dilma believes she has an ace up her sleeve.

Off-Shore Oil Reserves & Reform

In 2007, hydrocarbon surveyors found massive deep sea oil fields off the coast of Brazil. These finds have increased the country's probable oil reserves from 20 billion barrels to well over 50 billion barrels. Despite supreme engineering challenges, President Dilma believes Brazil can mine these fields and use the resultant hydrocarbon profits to address education and infrastructure deficits. However, the very education, infrastructure and corruption issues themselves could prevent Brazil from successfully accessing and administering the new hydrocarbon treasure trove.

The next few years will provide crucial tests for Brazil



Extracting the *pre-sal* oil will require significant infrastructure, and President Dilma hopes to stimulate Brazilian production by building these inputs domestically. To this end, her government has implemented local-content laws that require oil extraction to be conducted with machinery built in Brazil. The increase in productivity could create thousands of jobs and generate billions of dollars within the Brazilian economy.

However, Brazil's poor education system has not prepared the required number of engineers and skilled laborers to execute such a feat of domestic production. President Dilma hopes to use hydrocarbon windfall profits to invest in education, but such improvements will take time, especially as much of the valuable hydrocarbons remain buried deep beneath the ocean. In the meantime, the Brazilian labor force will struggle to produce the required materials to access the *pre-sal* oil reserves. Thus,

[4] Gini coefficient is commonly used as a measure of inequality of income or wealth

Dilma's domestic-content laws could retard Brazil's access to its newly found hydrocarbon treasure.

Furthermore, pervasive corruption could hinder Brazil's dream of using *pre-sal* oil windfalls to eradicate poverty. Success would require clear goals and prudent, long-term money management. Venezuela offers a clear example of what happens if hydrocarbon windfalls are used as a piggy bank for an inefficient and corrupt system of social services.

The Country of the Future?

Thus, the three long standing barriers to Brazilian developments persist: Education, infrastructure, and corruption. Yet progress has been made, and the ruling PT Party has expressed a commitment to continue to tackle these issues. No better acid test could exist than the stated goal to double oil exports by 2020. Withdrawing oil from *pre-sal* fields will require significant infrastructure development, educational know-how, and increased productivity. Meanwhile, the windfall profits will test Brazil's ability to eradicate corruption and manage profits wisely.

President Dilma has stated that off shore oil finds are proof that God is Brazilian. If so, perhaps the ability to handle the windfall will be Judgment Day for Brazilian developmental aspirations.

Financial Sector Briefing:
So Far So Good

I. Introduction

Despite persistent global economic turbulence, Brazilian public, private and international banks have proven well capitalized, consistent and reliable. Both public facilities such as *Banco do Brasil* and private banks such as *Banco Itaú* have achieved investment grade credit ratings according major international credit rating agencies.

Capital markets have demonstrated improvements, with the sovereign and major firms able to issue debt of reasonable length in the domestic *real*. The major index for the Brazilian stock market (IBOVESPA[5]) has maintained a relatively consistent climb over the last five years, rebounding from dips in 2008-2009 and 2012.

Financial sector stability, high growth and high interest rates have helped make Brazil an attractive destination for international capital. While such 'hot-money' could invite a host of problems, the country's financial system demonstrated maturity and resilience during the global recession, suggesting that it may be prepared for 21st century financial challenges.

This briefing begins by considering the Brazilian financial system's performance during the Great Recession. It proceeds to consider the current state of affairs in the financial sector, highlighting certain key successes, as well as areas of concern. The paper concludes by considering sector's position in facing a double-dip recession, as well as a recent trend of sluggish growth.

II. Financial Sector Performance During the Great Recession

A memorable quote from the crisis-era stated, "When the water gets shallow, we see who is swimming naked." The Brazilian financial sector's successful navigation through the global recession proved that it was wearing a bathing suit. In a show of successful regulation, Brazilian banks were very well capitalized as the global financial system teetered. Brazilian institutions maintained high "Basle Rates" (percentage of capital assets in reserve), well above the required 11%. These reserves allowed Brazilian banks to cover temporary external trade deficits.

Brazilian banks managed to stay well capitalized partially due to their heavy exposure to (theoretically) risk-free Brazilian government bonds as opposed to more risky instruments such as mortgage backed securities. Given high interest rates in the home market, Brazilian banks had no need to search for risks in order to find returns. However, in light of the European Debt Crisis, this sovereign exposure led Moody's to downgrade a number of Brazilian banks in June 2012 to match the country's sovereign rating of Baa2.

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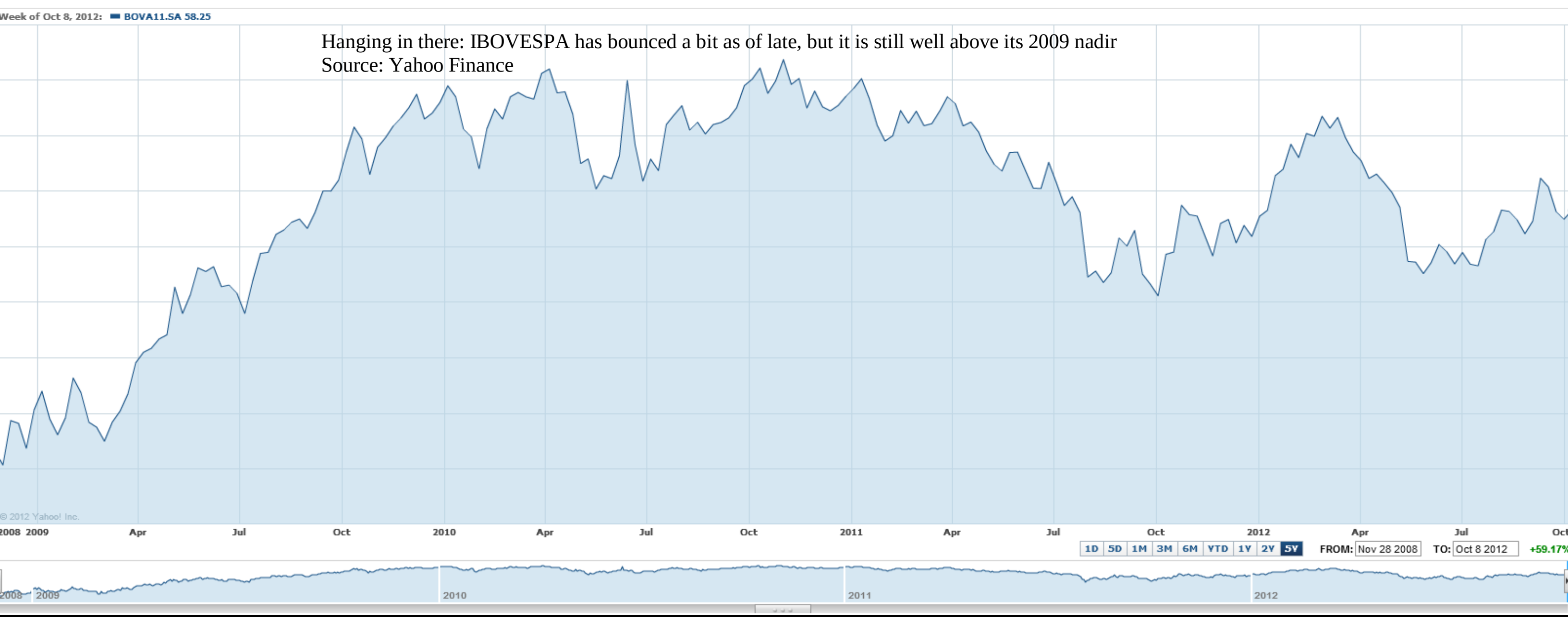
[5] IBOVESPA, the most important Brazilian stock market indices, measures the average performance of the most traded stocks in the overall portfolio

The crisis of 2008 did lead private banks, both foreign and domestic, to tighten credit. The federal government successfully thawed this credit freeze with a massive government transfer to the state owned development bank, *Banco Nacional de Desenvolvimento Economico e Social* (BNDES). As part of the government's counter-cyclical response to the crisis, Law 11,948 of June 16th, 2009 authorized a transfer totaling R$180 billion from the Ministry of Finance to the *BNDES* for immediate credit disposal for development projects. Brazil's crisis response underscores the importance of state owned banks in Brazil – an approach with short term benefits, but potential long term disadvantages.

While the Brazilian public equity market took a hit at the onset of the crisis, its rebound suggests resilience. The years prior to the crisis were marked by asset price appreciation that generated a 20% rise in the Brazilian stock index between June 2007 and June 2008. In this period, BOVESPA saw issuances worth a record 5.6% of GDP (R$ 165bn). However, with the collapse of Lehman Brothers, BOVESPA demonstrated a brief but exceptionally high level of variance increase with the United States Stock Market, and it took a swift dive.[6] The BOVESPA index experienced drops in both 2011 and 2012, but it has remained in the vicinity of the 2010 rebound.

Overall, through countercyclical efforts such as channeling funds through *BNDES* and spot market sales of US dollars, the Brazilian Central Bank and the Federal Government relied on an arsenal of international reserves to stimulate their way through the crisis. However, since this spending spree, Brazil has not only replenished the fx reserves, but it has also *increased* its overall reserve position by 35% since 2008.



Hanging in there: IBOVESPA has bounced a bit as of late, but it is still well above its 2009 nadir
Source: Yahoo Finance

6 Gilles Dufrenot, Valéarie Mignon and Anne Péguin-Feissolle. "Spillovers of the Subprime Crisis to Latin American Equity and Stock Markets: An Empirical Assessment Based on the Time-Varying Probability Markov-Switching Models." (April 10, 2010). Available online at http://congres.afse.fr/docs/2010/785852dufrenot_mignon_peguin.pdf.

3. Successes & Concerns

While expensive and hardly pain free, the Brazilian financial sector performed well during the Great Recession, and has remained stable even as domestic growth has declined during the European sovereign debt crisis. Moving forward, this brief highlights areas where the sector has demonstrated impressive successes, as well as some areas that could prove to be concerns in the future.

Bright Spot: Loans Issued in Domestic Currency

Latin American countries have historically been victims of the so-called 'double mismatch' in which short term, hot-money loans are issued in American dollars to governments, firms and families that use the loans to execute long term projects that pay off in the domestic currency. In what appears to be a major success, Brazilian sovereigns and firms are currently issuing bonds at fixed rates, in *reais*, and of increasing duration.

In September of 2005, Brazil issued ten year bonds with 12.5% coupon payments in domestic currency, totaling R$3.4bn. These issuances, which oversubscribed several times, demonstrated that global investors were prepared to accept Brazilian risk.

Bright Spot: Premium Domestic Listings

The implementation of a stock listing system in 2000 has allowed firms to select which category of stock to list in, and thus, which requirements it must meet. This has added depth and breadth the Brazilian equity market. The availability of a premium listing has reversed the trend of important Brazilian firms preferring to list abroad. These premium listings grant minority shareholders the right to enforce mandatory arbitration (to be settled by the *Camara de Arbitragem do Merado*) on firms accused of not meeting corporate governance requirements. The system also contains listing tracks specially tailored to small and medium sized enterprises, encouraging growth in the kinds of firms that have struggled to reach the markets in many emerging economies.

Premium offerings seem to have led firms to migrate back from foreign markets to BOVESPA listings. In March 2011, 20 Brazilian firms listed abroad – down from 32 in March 2010. Interestingly, the firms most likely to migrate back to premium listings had greater assets and leverage in comparison to non-migrating firms, suggesting that firms with more opportunities for growth are more intrigued by BOVESPA premium listings – a trend that bodes well for the domestic stock exchange in the long run.

Bright Spot: Initial Public Offerings

Increased confidence in BOVESPA has generated a promising trend of initial public offerings (IPOs). Beginning in 2004 when 7 Initial Public Offerings (IPOs) were placed on BOVESPA, IPOs have been on the rise in Brazil, suggesting confidence, capacity and growth in the Brazilian domestic equity market. By 2009, BOVESPA ranked third globally in volume of initial public offerings. After witnessing only six firms put up for IPOs in 2009, firms placed 11 IPOs on the local exchange in 2010 and 11 more in 2011.

34 of the 43 IPOs since 2001 selected the premium-track offering which triggers the highest governance standards. Perhaps most telling, while only three of these firms chose to cross list on the New York Stock Exchange, an average 69.2% of the offerings were purchased by

foreigners, leading to the powerful conclusion that Brazilian firms do not need to list in the U.S. in order to gain access to international capital.

Potential Concern: Excessive Bank Consolidation

Bank consolidation helped the Brazilian financial system beat the crisis, but such conglomeration poses long term concerns. *Banco Itaú* and *Banco Bradesco* account for 17% and 11.6% of the market respectively.[7] The fact that no other private bank accounts for more than 2.5% of the market attests to the consolidation in the private banking sector. In 1994, there were 243 private banks in Brazil. This number fell to 180 in 2002, and 156 by 2011.

The long term effects of this trend are ambiguous. Potential positive externalities include economies of scale, and the ability of bigger banks to better weather macroeconomic shocks. However, such consolidation could undermine competition and open the door to growth-stunting interest rate collusion.

Potential Concern: A Real-Estate Bubble

As demonstrated by the United States in 2008, real-estate bubbles, when burst, can pose a dramatic threat to a country's financial system. Brazil may be developing such a bubble. In the last five years, real-estate prices in Rio de Janeiro have increased on average between 100 – 300 %.[8] With housing prices rising by an average of 24.7% in the month of April 2011 *alone*, the effects are felt throughout the country, with stiff increases even in poor neighborhoods – a dangerous sign for a country infamous for its inequality.

Economists debate whether these increases constitute a bubble. After all, the recent emergence of Rio de Janeiro and Sao Paulo as global hubs should put upward pressure on prices in a market that had previously stagnated for years. Furthermore, as millions of Brazilians emerge from poverty to join the burgeoning middle class, the general upward pressure on housing prices may be sustainable, at least in the mid-term.

In fact, the housing boom may reflect the maturity of Brazilian finance. A recent Inter-American Development Bank working paper entitled *Housing Finance in Brazil* argues that the newly developed ability to issue long term finance (longer than 15 years) has helped shape the previously underdeveloped Brazilian housing market.

However, while housing prices should be increasing, the percent changes seem excessive, suggesting at least a partial bubble. A major factor in the values increases is shortage, but there is no shortage of developers constructing new units to meet the growing demand. Should they oversupply, values will fall. A bursting of a bubble, whether through sudden oversupply or through mass mortgage defaults would put significant stress on the Brazilian financial system.

[7] Economist Intelligence Unit, *Brazil: Country Finance,* 2011. 34.
[8] See an excerpt of this Al Jazeera report online at http://www.youtube.com/watch?v=Zv43e-p7O1g

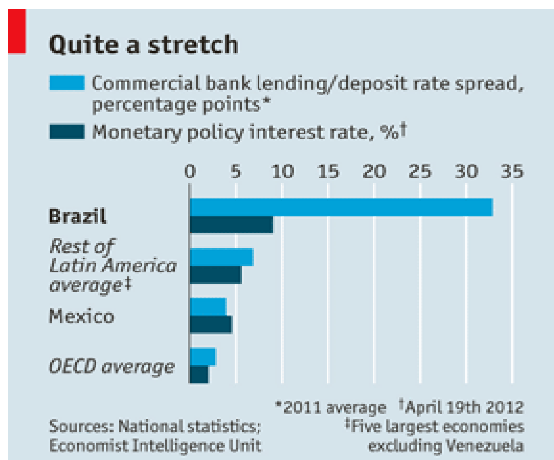
Interest Rates

In April, 2012, Brazilian bank Caixa Econômica Federal advertised an interest rate cut to 51% as "historic" and "unbeatable." It may shock international observers to learn that, to Brazilians, this was in fact an intriguing offer. After all, *CEF* was dropping its annual overdraft rate down from 157%.[9]

Though rates have declines since the 1980 and 90s, the cost of credit in Brazil remains high, dampening potential investment. Retail loans average 40% interest rates (down from the low 70 percentiles in 2002). Corporate loans dipped towards 30% interest rates in January of 2008, but they spiked during the financial crisis and by 2010 they were hovering around 40%.

Interest rates on mortgage loans are dangerously high, averaging around 40% annually. Such rates could quickly become unsustainable should Brazil face a prolonged economic slump. Any such circumstances would be exacerbated if the capital inflows that have generated a strong *real* were to decline (as they tend to do during slumps), and the *real* would subsequently depreciate against the dollar. This would lead to depreciation in real value across the housing market.

One explanation for these high rates concerns Brazil's history of price instability and inflation. Furthermore, bankruptcy laws may overly protect borrowers, making it difficult and expensive for banks to execute guarantees. The recovery rate on defaulted loan is comparatively low, at about 15% in 2009. This a concern for Brazilian banks as they have witnessed delinquent payments "increasing gently." Bankrupt reform laws were passed in 2005, and the BCB has recently introduced a new credit information system and payroll-backed loans. The effects of these reforms remain to be seen.



The Central Bank of Brazil has consistently cut the base rate to stimulate lending. However, commercials spreads remain high

A more sinister explanation for the high rates points to the increasing degree of bank concentration. A Working Paper from BCB acknowledges speculation that such concentration can create oligarchy price setting power.

Whatever the reason, the high rates remain despite persistent government efforts to stimulate lending though base rate (SELIC) cuts. Not only do these high interest rates slow the Brazilian economy, but, as boom times become a recent memory, it will be increasingly difficult for many families to service existing loans.

[9] Ibid.

4. Conclusions: Preparation for Double Dip Recession

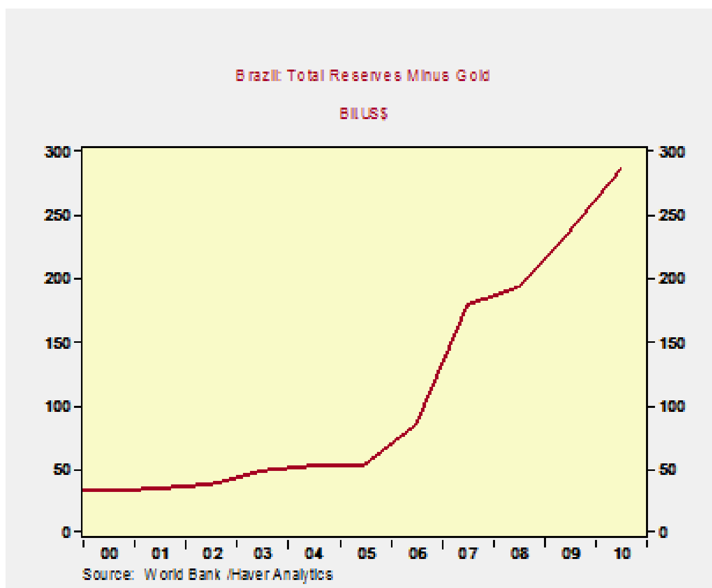
This brief began by considering the Brazilian financial sector's performance during the global recession of 2008-2009. It concludes by considering the sector's preparedness for a potential double-dip recession instigated by the European sovereign debt crisis.

Brazil's economy appears well cushioned against a moderate external shock, although a synchronized deterioration in global economic or credit conditions would likely be disruptive to the financial sector.

During the first crisis, a major channel of contagion was a freeze in capital inflows and a subsequent freeze in domestic credit. The government is currently fighting to once again free credit flows. However, these constraints may be offset by the thriving *real*-denominated bond issuances that inject local currency into the market. Furthermore, now with well over US$320bn in fx reserves, the Brazilian government is once again in a position to infuse significant liquidity into the credit market should financing channels dry.

The *Banco Central do Brasil* has slashed its central policy rate (known as the SELIC) from 12.5% in August 2011 down to historic low of 7.25 in October 2012, as the BCB continues efforts to stimulate a flagging economy. Theory holds that as the SELIC falls, potential investors will be less satisfied with the risk-free rate of return and more likely to loan money in the capital markets, perhaps preventing a credit-freeze. The cuts *should* also ease private sector interest rates.

Finally, Brazil's diversified trade patterns, particularly its exposure to China (Brazil exports roughly 33% more to China than to the United States, and Asia accounts for nearly three times the Brazilian exports as the United States does), will partially protect its financial sector against future turbulence related to the European sovereign debt crisis. However a Chinese economic downturn would pose a significant threat to the Brazilian financial system



The Brazilian Government has the FX to support the financial sector

Turbulence should be expected, but the long term outlook on the Brazilian financial sector is positive.

Foreign Policy Briefing:
The Brazil – USA – China Triangle

Long an economic basket case and bloated backwater, Brazilian democracy has been entrenched (if not robust) since the Presidency of Fernando Henrique Cardoso (1995-2002). Meanwhile, the country has averaged over 4% GDP growth from 2003 to 2010, while inflation has been held in check. During Presidency of Luiz Inácio Lula, Brazil became a world player with ambitions to one day become a global power.

However, much to the chagrin of the Brazilians, they have struggled to maintain the attention of US Foreign Policy. The United States appears to expect Brazilians to instinctively follow American lead on global issues, and when Brazil does not, relations become increasingly estranged. Meanwhile, Brazil feels that the United States' foreign policy does not encourage their economic rise: if anything, the cheap American dollar is flooding the Brazilian market and putting upward pressure on the *real*. Overlooked by American foreign policy, Brazil has actively increased economic ties with China. To better understand the intricacies of this triangle, this briefing considers the perspectives of each country in turn.

The Brazilian Perspective

Rubens Barbosa, a former Brazilian ambassador in Washington, stated in April that, "American officials seem to know less about Brazil than any other big economy." [10] Brazilians consistently perceive slights from Washington, most recently when President Dilma Rousseff was not afforded a state dinner during her trip to Washington (April 9th-10th, 2012). One Brazilian official, speaking anonymously, contrasted the tepid reception of Rousseff with the red carpet roll-out for British Prime Minister David Cameron a month earlier, "even though Brazil surpassed Britain last year to become the World's sixth-biggest economy."[11]

While dinner might seem a trivial topic, other issues carry more weight. Brazil has consistently sought the United States' support in its bid to join the United Nations Security Council as a permanent member. American diplomatic support of Brazil would seem to be a minimal-risk venture. Brazil is a non-nuclear power in a relatively war free zone. It has led the U.N. stabilization mission in Haiti since 1994, and has helped the Colombian government rescue hostages held by guerrillas.

Nevertheless, American support for Brazil's bid has been slow and unconvincing. For example, during Rousseff's April visit, President Barack Obama 'acknowledged' Brazil's aspiration for permanent membership without supporting it. This, Brazilians are quick to note, is in stark contrast to America's support of India's 2010 quest to join the counsel.

Economically, American foreign policy appears aloof to Brazilian growth ambitions. In March 2012, the US Air Force cancelled a contract to purchase 20 Super Tacano Jets from

[10] "Brazilian – American Relations: One Step At a Time." *The Economist*, 4/14/2012. Available online at http://www.economist.com/node/21552592
[11] "What Brazil Wants from White House Visit: Dinner." *Reuters*, 4/7/2012. Available online at http://www.latinospost.com/articles/394/20120407/what-brazil-white-house-visit-dinner-dilma-rousseff.htm

Brazilian national-champion Embraer S.A. A small purchase by US military standards (the 20 aircrafts were to sell for USD$355mn), the contract was "a showcase deal for Embraer,"[12] and Brazilians expected the successful execution of the contract to lead to subsequent deals with Western European powers. The Embraer contract's cancellation has thus caused considerable consternation.

Furthermore, expansionary monetary policy in the United States has incentivized carry trade opportunities in Brazil, where the Central Bank base rate (known as the SELIC) remains relatively high at 7.25%. The influx of US dollars has appreciated the *real* to the determinant of the Brazilian manufacturing sector. US macroeconomic policy decisions may not have been made specifically to hurt Brazil, but they solidify the Brazilian perspective that their interests are of little concern to Washington.

From the Brazilian perspective, apparent US indifference contrasts with the Chinese foreign policy approach which has included billions of dollars of investment in much needed Brazilian infrastructure (not to mention a state dinner held for President Rousseff in Beijing during her April 2012 visit).

In 2010, Chinese foreign direct investment in Brazil topped USD$20bn, making China the biggest investor in Brazil - quite a feat considering that in 2009, the Chinese ranked 29th in investment in Brazil.[13] Furthermore, it has been Chinese demand for Brazilian commodities that has helped spur Brazilian growth. For example, in 2009, Brazil exported USD$6.3 billion in soybeans to China, 56% of all Brazilian foreign sales of this commodity.[14]

Chinese state-owned enterprises such as Chongqing Wanzhou Grain and Oil Group have invested heavily in downstream Brazilian soy processing, thus solidifying a relationship that the US Agriculture Department expects to grow exponentially. Thus, for the Brazilians, Chinese foreign policy emphasizes traits that have led to impressive Brazilian growth.

The United States Perspective: Brazil does not play a key role in the drug trafficking chain that annually introduces billions of dollars of contraband into the United States. Illegal migration from Brazil is not a major issue, and while Brazilian politics have tacked towards the center-left since the ascension of President Lula, Brazil has not joined the explicitly anti-US ALBA, an international cooperation organization.

Furthermore, US resource security does not require access to Brazilian soy or iron. As such, American foreign policy has largely overlooked Brazil in the 21st century. In fact *because* Brazil is non-nuclear, and *because* Latin America is relatively stable, Washington policy makers appeared comfortable affording limited attention to the country in the post-9/11 era.

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[12] Joe Leahy. "Embraer Aims for Second Shot At US Jet Contract." *The Financial Times,* 3/26/2012. Available online at http://www.ft.com/intl/cms/s/0/4ac5fffe-775f-11e1-93cb-00144feab49a.html#axzz1smVXJhlD

[13] John Pomfret. "China Invests Heavily in Brazil, Elsewhere in Pursuit of Political Heft." *The Washington Post,* 7/26/2010. Available online at http://www.washingtonpost.com/wp-dyn/content/article/2010/07/25/AR2010072502979.html?sid=ST2010092006580

[14] Fabio Silveira and Giseli Carbrini. "China and the Brazilian Soybean Production." *Watershed,* 2009. Available online at http://www.watershed.com.br/article/193/china-and-the-brazilian-soybean-production.aspx

With regards to Brazil's United Nations Security Council bid, the US continues to view Brazil as a bit of an unpredictable player on the global stage. President Lula's 2010 attempt to negotiate an anti-proliferation agreement with Iranian President Mahmoud Ahmadinejad was particularly met by American disapproval.

Faced with consistent Brazilian growth, as well as recent pre-salt offshore oil finds that could make Brazil one of the world's elite hydrocarbon exporters, the Untied States has made efforts to solidify the relationship. A major step in the right direction occurred when American policymakers allowed a long-standing tariff against Brazilian ethanol to expire on January 1st, 2012. However, the American absence from the region allowed another BRIC to develop important ties with Brazil.

The Chinese Perspective: Whereas the United States found Brazil irrelevant to a foreign policy based on drugs, migration and regional politics, China has found Brazil particularly relevant to a foreign policy based on resource security and export expansion. Successful execution of both prongs of this foreign policy left China as Brazil's number one trading partner by 2009.

China's approach to Brazil is not without controversy. With nearly 84% of Brazil's 2010 exports to China raw materials and 98% of China's exports to Brazil manufactured products, the relationship has spawned comparisons to colonial Latin American economies. However, while Brazil pushes for a 'more sophisticated relationship' with China, Chinese foreign direct investment in the region will continue to guarantee preferential access to Brazilian commodities.

For example, a USD$10bn Sinopec investment in Petrobras could prove integral to Brazilian efforts to develop the infrastructure needed to extract oil from massive pre-salt reserves. Chinese investment could well give the East Asian country preferential access to Brazilian oil – access that could well have been American had the US not neglected Brazil.

Commodity Export Destinations 2010
Top Five (Share Commodity Exports)

	1	2	3	4	5
Argentina	China (11.2%)	Brazil (5.1%)	Chile (4.8%)	Iran (3.1%)	USA (2.8%)
Bolivia	Brazil (36.8%)	Argentina (8.1%)	Japan (7.1%)	Belgium (5.9%)	Korea (5.7%)
Brazil	China (18.3%)	Japan (3.3%)	USA (3.2%)	Russia (2.7%)	Netherlands (2.2%)
Chile	China (25.2%)	Japan (9.8%)	USA (7.2%)	Korea (5.2%)	Brazil (5.2%)
Colombia	USA (47.2%)	China (5.2%)	Netherlands (4.7%)	Switzerland (2.3%)	Panama (2.0%)
Peru	China (13.8%)	USA (7.2%)	Japan (4.9%)	Germany (2.8%)	Chile (2.7%)
Uruguay (09)	Free Zones (17.1%)	Brazil (8.2%)	Russia (4.8%)	Iraq (2.5%)	Spain (2.5%)
Venezuela	N/A	N/A	N/A	N/A	N/A
Mexico	USA (71%)	Spain (5%)	China (1%)	Canada (1%)	India (1%)

China: A major stimulator of the Brazilian economy