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POLITICAL RISKS OF INCREASED RELIANCE ON DEFENSE IMPORTS FROM BRAZIL

The U.S. Air Force is considering bids for aircraft to serve as counterinsurgency fighters and trainers for foreign partners. It seeks an inexpensive armed light attack support and reconnaissance aircraft for countries that can't afford top-of-the-line aircraft. One major competitor for the Air Force contract is the Brazilian company Embraer (Empresa Brasileira de Aeronautica). Its Super Tucano aircraft is already in service in Brazil, Colombia, and the Dominican Republic, and it has been ordered by at least five other countries (Indonesia, Lebanon, Chile, Guatemala, and Ecuador). If Embraer wins the contract, the Super Tucano could enter the air forces of countries such as Iraq and Afghanistan. Moreover, given the frequency of counterinsurgency campaigns in twenty-first century warfare, the purchase of even a small number of Super Tucano aircraft now could develop into much larger orders in the future.

As the United States considers increasing its military imports from Brazil, it is important to examine the risks that come with developing the bilateral defense trade relationship. The U.S. will need to assess how its interests could be jeopardized by Brazil's long-standing anti-Americanism, its overall foreign policy, and its practice of subsidizing its defense industry. This paper examines each of these issues and suggests that they will continue to pose problems as Brazil gains military and economic power in a more complex global environment.

Although international defense procurement, particularly among key NATO allies, is critical to U.S. defense efforts, the direction of Brazil's economic and foreign policy raises questions as to whether Brazil can currently be a reliable procurement partner for the U.S.

BRAZILIAN ANTI-AMERICANISM

Polling information indicates that anti-Americanism is stronger in Brazil than in a number of other Latin American countries.¹ There are several reasons for this. First,

¹ House Foreign Affairs Subcommittee on International Organizations, Human Rights, and Oversight and the Subcommittee on the Western Hemisphere, *Polling Data on Latin American Opinion of United States Policies, Values and People* (Washington, DC: U.S. Government Printing Office, 2007). Available at <http://foreignaffairs.house.gov/110/33824.pdf>.

See also:

Brazil is able to chart a more independent course toward the U.S. than many other Latin American countries. The largest country in the region in size and population, it can meet many of its own needs and doesn't rely upon U.S. trade as much as many of its neighbors—only about a fifth of the Brazilian economy is trade. The trade relationship that does exist between the United States and Brazil has been notably turbulent and subject to many disputes over subsidies of key agricultural exports.

A second reason for Brazil's "anti-Yanqui" sentiment has to do with the events of the Cold War (see below). This sentiment has been intensified both by perceived unfair trade practices after the end of the Cold War and by opposition to U.S. foreign policy after 9/11. In one remarkable poll from October 2003, 98 percent of Brazilian elites gave President George W. Bush a negative rating.²

Cold War

Modern Brazilian grievances against the United States developed during the Cold War. In the early 1960s, leftist President João Goulart made several domestic and foreign policy decisions that raised U.S. fears about a possible dictatorship and an eventual Communist takeover. The U.S. ambassador to Brazil, Lincoln Gordon, wrote in 1964 that "Goulart is now definitely engaged on a campaign to seize dictatorial power, [and is] accepting the active collaboration of the Brazilian Communist Party, and of other radical left revolutionaries to this end."³

Whatever Goulart had in mind, it did not materialize. A combination of Brazilian military forces and civilians overthrew President João Goulart in late March/early April 1964. The U.S. certainly sympathized with this uprising, but the extent of actual support is still unclear. President Lyndon Johnson welcomed the uprising and told Undersecretary of State George Ball that "we ought to take every step that we can, be prepared to do everything that we need to do" to support it.⁴ On the other hand, Ambassador Gordon denied any U.S. involvement, asserting in testimony before Congress that "neither I nor

ICM Research, "What the World Thinks of America," 6 June 2003, p. 1, Available at http://www.icmresearch.co.uk/pdfs/2003_june_bbc_what_world_thinks_of_america.pdf.

² October 2003 Zogby International and University of Miami Business School Poll, cited in Lobe, Jim. "Bush falls from favor abroad, too," *Asia Times*, October 30, 2003. Available at http://www.atimes.com/atimes/Front_Page/EJ30Aa01.html

³ Gordon, Lincoln. "Top Secret Cable from Rio de Janeiro," 27 March 1964. Available at <http://www.gwu.edu/~nsarchiv/NSAEBB/NSAEBB118/bz02.pdf>.

⁴ White House Audio Tape, "President Lyndon B. Johnson discussing the impending coup in Brazil with Undersecretary of State George Ball," 31 March 1964. Available at <http://www.gwu.edu/~nsarchiv/NSAEBB/NSAEBB118/LBJ-Brazil.mp3>.

other officials in the U.S. Government, nor the Government in any way, shape, or manner was involved, aiding and abetting or participating.”⁵

Rightly or wrongly, many Brazilians believed that the U.S. had meddled in their affairs.

Post-9/11

Even Fernando Henrique Cardoso, who was president from 1995 to 2003 and whom Brazilians see as a market-oriented, classically liberal leader, expressed significant anti-American sentiment. In a speech to the French National Assembly shortly after September 11, he proclaimed that “barbarism is not only the cowardliness of terrorism but also the intolerance or the imposition of unilateral policies on a global scale.”⁶ A September 2001 poll showed that 79 percent of Brazilians opposed any military response against the Taliban for having sheltered those responsible for the 2001 terrorist attacks against the U.S.⁷

America’s subsequent prosecution of the Iraq War did not help relations between Brasilia and Washington. The election in 2002 of President Luiz Inácio Lula da Silva, a leftist labor leader, seemed to promise more trouble for the U.S.-Brazil relationship. The U.S. feared that da Silva would work with other rising leftist leaders in Latin America, such as Venezuela’s Hugo Chávez, to construct a new anti-American alliance. While the worst of these fears did not materialize, a constant stream of anti-American rhetoric reinforced Brazilians’ less than favorable opinion of the U.S. policy differences between the two countries over the last decade have hardened this anti-American sentiment.

BRAZIL’S FOREIGN POLICY AND TENSIONS WITH THE U.S.

In addition to Brazil’s anti-Americanism, its foreign policy bears watching as the United States weighs increasing its military imports from Brazil.

Trade

Major Brazilian exports compete directly with American products. Brazil produces coffee, citrus, sugar, beef, and poultry—the same products that the U.S. produces in large quantities. Although President Fernando Henrique Cardoso generally supported

⁵ Senate Foreign Relations Committee. *Nomination of Lincoln Gordon to be Assistant Secretary of State for Inter-American Affairs* (Washington, DC: U.S. Government Printing Office, 1966), p. 44.

⁶ Maxwell, Kenneth R. “Anti-Americanism in Brazil,” Council on Foreign Relations Correspondence, Spring 2002, Available at <http://www.cfr.org/americas/anti-americanism-brazil/p4468>.

⁷ Ibid.

free trade, there were bitter disputes over subsidies, tariffs, and quotas during the negotiations for a Free Trade Agreement of the Americas (FTAA) that took place while he was in office. These negotiations faltered, and trade disputes continued during President da Silva's presidency.

At issue were products ranging from cotton and orange juice to steel and ethanol. In a number of cases, progress was slowed by domestic politics in both the U.S. and Brazil. Protected industries resisted the lifting of tariffs or the reduction of subsidies that helped them survive. Brazil took its case to the World Trade Organization (WTO) toward the end of the Bush administration.

In March 2010, Brazil raised tariffs on U.S. cosmetics, appliances, and cars to counter U.S. cotton subsidies. Previously, the WTO had authorized Brazil to impose up to \$829.3 million in retaliatory sanctions in response to U.S. cotton subsidies.⁸ Brazil also won a WTO case regarding U.S. sugar subsidies. In the midst of these victories, da Silva derided the United States as an elephant, large but fearful: "The trunk is as big as 10 rats, but put a mouse near the elephant and see how the beast trembles and wets itself."⁹

Iran

Another area of tension between Brazil and the United States concerns Iran.

President da Silva sought a mediating role between Iran and western countries on nuclear issues. At the September 2009 G-20 meeting in Pittsburgh, he expressed support for an Iranian nuclear program "for peaceful means."¹⁰ In November 2009, he invited Iranian President Mahmoud Ahmadinejad to Brazil. In May 2010, he helped broker a deal in which Iran would ship only a portion of its low-enriched uranium to Turkey for reprocessing; the rest would remain in Iranian hands, where it could be further enriched for nuclear weapon production. Critics of the deal, such as Secretary of State Hillary Clinton, emphasized that it made the world "more dangerous, not less,"¹¹

⁸ "Lula calls on Obama to resolve trade dispute," *Agence France Presse*, 10 March 2010, Available at <http://www.france24.com/en/20100310-lula-calls-obama-resolve-trade-dispute>.

⁹ "Brazilian mouse made U.S. elephant run on trade: Lula," *Reuters*, 8 September 2010, Available at <http://www.reuters.com/article/2010/09/08/us-brazil-usa-lula-idUSTRE6875M520100908>.

¹⁰ "Evidence needed to prove Iran's nuclear program: Brazilian president," *Xinhua*, 26 September 2009, Available at http://news.xinhuanet.com/english/2009-09/26/content_12112893.htm.

¹¹ Clinton, Hillary R. "Remarks on the Obama Administration's National Security Strategy," 27 May 2010, Available at <http://www.state.gov/secretary/rm/2010/05/142312.htm>.

as it undermined U.N. Security Council resolutions that called on Iran to halt uranium enrichment.

Da Silva's benign view of Iran went beyond his opinion that Tehran's nuclear program was intended for peaceful purposes. He also supported Ahmadinejad and the Iranian regime at critical moments. After the June 2009 Iranian elections, da Silva dismissed the large numbers of Iranians who took to the streets to protest what they saw as a rigged election. He compared the voters to "*flamenguistas* and *vascainos*"—fans of two rival Brazilian soccer teams—and said of Iran: "It is not the first country that holds an election in which someone wins and the loser protests."¹²

Da Silva also weighed in on Iran's treatment of women in August 2010. When Iran was prepared to stone to death a woman accused of adultery, da Silva offered to provide her asylum in Brazil. But during a campaign rally in southern Brazil, da Silva implied that his offer was really intended to help the Iranian government more than the woman herself:

I have to respect a country's laws, but if my friendship and [the] regard I have for the president of Iran and the Iranian people is worth something, if this woman is causing discomfort, we could take her in Brazil.¹³

Da Silva had great confidence in his negotiating skills, and possessed a strong belief that sufficient negotiations could solve the world's problems. In a 2010 press conference, Russian President Dmitry Medvedev and da Silva discussed the chances that the latter could convince Iran's leadership to cooperate with the international community on nuclear issues. Medvedev said, "The president of Brazil is an optimist, so I'll be an optimist too . . . I give him [a] 30% chance of success."¹⁴ Da Silva responded by saying that his chances were 99 percent.

Latin America

Throughout his presidency, President da Silva provided material and rhetorical support to anti-American leftist leaders across Latin America. Speaking in Venezuela on November 13, 2006, he linked himself with some of the most anti-American leaders the region produced, asserting that "it's the same people who elected me who elected

¹² Chade, Jamil. "Para Lula, protesto é choro de 'perdedores' [For Lula, the protests are the cries of 'losers']," *O Estado de S. Paulo*, 16 June 2009, Available at http://www.estadao.com.br/noticia_imp.php?req=not_imp387944,0.php.

¹³ "Iran dismisses Brazil asylum offer," *al Jazeera*, 3 August 2010, Available at <http://english.aljazeera.net/news/middleeast/2010/08/20108316141659533.html>.

¹⁴ Pronina, Lyubov. "Medvedev Gives Lula 30% Chance of Convincing Iran on Nuclear Cooperation," *Bloomberg*, 14 May 2010, Available at <http://www.bloomberg.com/news/2010-05-14/medvedev-gives-lula-30-chance-of-convincing-iran-on-nuclear-cooperation.html>.

Kirchner, who elected Daniel Ortega, who elected Evo Morales.” He also implied that President Hugo Chávez cared about the poor in a way that previous leaders had not: “I have no doubt that for many years here in Venezuela there wasn’t a government that worried about the poor.”¹⁵ A year and a half later, in an interview with *Der Spiegel*, da Silva called Chávez “the best president that Venezuela has had in the last 100 years.”¹⁶

Some observers argue that da Silva actually pursued a “milder and more pragmatic”¹⁷ course than these quotations suggest, maintaining good relations with President George W. Bush and continuing many market reforms begun by his predecessor, Fernando Henrique Cardoso. According to a *New York Times* report, “Mr. da Silva has steadily peeled himself away from Venezuela’s leader and quietly supplanted him as he nurtures Brazil into a regional powerhouse.”¹⁸ A *Los Angeles Times* profile of da Silva echoed that sentiment:

Whether he’s sloughing off Chávez’s strident anti-Americanism or privatizing roads and power plants in Brazil, the former union firebrand who emerged from the assembly lines of São Paulo has repeatedly defied stereotypes since taking office in 2003 as the avatar of a new generation of leftist leaders. He has gone from being what some considered a radical bent on imposing socialism to a free-market champion who still funds social programs for the poor.¹⁹

But such analyses overlook other actions da Silva took as president. He built a warm relationship with Fidel Castro (likening imprisoned regime critics to common criminals²⁰), promoted ultranationalists within Brazil’s foreign policy establishment, and gave far leftist advisor Marco Aurélio Garcia responsibility for Brazil’s South America

¹⁵ Sanchez, Fabiola. “Brazil’s Silva predicts re-election for Venezuela’s Chavez as two open bridge,” *Associated Press*, 13 November 2006.

¹⁶ “*Spiegel* Interview with Brazilian President Lula,” *Der Spiegel*, 10 May 2008, Available at <http://www.spiegel.de/international/world/0,1518,druck-552900,00.html>.

¹⁷ Romero, Simon and Alexei Barrionuevo. “Quietly, Brazil eclipses an ally,” *New York Times*, 7 July 2008. Available at <http://www.nytimes.com/2008/07/07/world/americas/07iht-07brazil.14284432.html>.

¹⁸ Ibid.

¹⁹ Kraul, Chris and Patrick J. McDonnell. “Lula’s stature grows in S. America,” *Los Angeles Times*, 5 October 2008. Available at <http://articles.latimes.com/print/2008/oct/05/world/fg-latin5>.

²⁰ “Lula criticised for Cuba comment,” *BBC News*, 11 March 2010, Available at <http://news.bbc.co.uk/2/hi/8561718.stm>.

policies.²¹ During the Honduran crisis, da Silva provided refuge to ousted President Manuel Zelaya in the Brazilian embassy. He also aligned with the Chavez regime in refusing to recognize the new government.

In combination with Brazil's skeptical view of the U.S. and da Silva's consistent opposition to U.S. policy on other fronts, these actions suggest a foreign policy less benign than what is described by da Silva's apologists.

EMBRAER

An additional significant concern that the United States should keep in mind as it considers Brazil as a supplier of military aircraft is linked to Brazil's practice of subsidizing its defense industry.

A History of Government Support

Embraer is the world's third-largest aircraft manufacturer—after Boeing and Airbus—and the producer of both civilian and military jets. It was founded in 1969 as a state-owned company and was designed to capitalize upon post-World War II investments in aerospace infrastructure and institutions, most notably the Aeronautical Technical Centre (CTA). CTA included research institutes and a university modeled on MIT, the Aeronautical Technology Institute (ITA). These institutions provided Brazil with a strong base of aeronautical engineers and airplane builders.²²

From the beginning, the Brazilian government made concerted efforts to build up Embraer. The government's influence is evident in that the company's first president was a Brazilian air force officer. Also, unlike other Brazilian firms, Embraer was allowed to buy components from foreign firms, though these foreign firms were themselves required to provide technological expertise to Embraer in order to enter the Brazilian market.²³

Embraer's initial projects, staff, and equipment were absorbed from various air force-related institutions. Moreover, the Brazilian government provided \$500 million in

²¹ "Lula and his squabbling friends," *The Economist*, 13 August 2009, Available at <http://www.economist.com/node/14229460/print>.

²² Silcoff, Sean. "Embraer jettisons its 'jungle jet' roots: Brazil takes flight," *National Post*, 26 March 2005, p. FP1.

²³ Ibid.

subsidies between 1969 and 1985. Embraer was exempt from taxes and received government loans and grants.²⁴ According to a 2002 World Bank report,

We do not know whether the company could have succeeded without substantial government support. Moreover, it is not clear that the net present value of the public investments made in Embraer are positive, even considering its recent commercial success.²⁵

Indeed, Embraer was in danger of bankruptcy before it was privatized in December 1994. The government wrote off \$700 million in debt and put an additional \$350 million into the company.²⁶ Despite its privatization, Embraer is still regarded as a “strategic company.” This means that its corporate governance differs from wholly private companies in a couple of important respects. First, the interest of foreign entities in Embraer’s voting capital is limited to 40 percent. Second, there is a special class of “Golden Share” held by the Brazilian government. The Golden Share provides the voting rights that common shareholders have, but also allows veto power over key policies that would affect Embraer’s defense business, including:

- Creation and/or alteration of military programs, whether or not involving the Federative Republic of Brazil
- Development of third parties’ skills in technology for military programs
- Interruption of the supply of maintenance and replacement parts for military aircraft
- Transfer of the equity control of the company.²⁷

Recent Subsidies

Even after Embraer’s privatization, the Brazilian government continued to support the company through subsidies. These subsidies were condemned by a World Trade

²⁴ De Ferranti, David M. (ed.). *From Natural Resources to the Knowledge Economy: Trade and Job Quality*, World Bank Latin American and Caribbean Studies: New York, January 2002, Chapter 4, p. 23. Available at <http://siteresources.worldbank.org/BRAZILINPOREXTN/Resources/3817166-1185895645304/4044168-1186325351029/07complete.pdf>.

²⁵ Ibid, p. 25.

²⁶ Silcoff.

²⁷ Embraer Website. “Golden Share,” Available at http://ri.embraer.com.br/Embraer/Show.aspx?id_materia=G3VjUsAc6HT0sKW92C8dLQ==.

Organization panel that authorized \$2.1 billion Canadian (C\$) in countermeasures by Canada. At issue was a program called PROEX (Programa de Financiamento às Exportações), which provided export credits to Brazilian exporters either through direct financing or interest equalization payments.

Created in 1991, the program provided significant benefit to Embraer. It worked by reducing the interest rate that foreign importers paid for financing transactions with Embraer. In effect, PROEX payments permitted “Embraer and the purchaser to negotiate more favourable export credit terms than they could otherwise achieve in the marketplace.”²⁸

When foreign airlines negotiated with Embraer over potential aircraft acquisitions, the Brazilian government committed itself to supply PROEX support if a deal was confirmed. Purchasers thus reduced their financing costs to levels below those offered in the financial markets, which provided a significant advantage to Embraer bids.²⁹ According to a WTO report, the cumulative total of Brazil’s subsidies was over C\$4 billion.³⁰

Canada filed suit at the World Trade Organization to prevent the PROEX payments, as the Canadian company Bombardier competes with Embraer to provide jet aircraft to regional carriers in the U.S. and other countries. The U.S./German manufacturer Fairchild Dornier filed a complaint with the European Commission.³¹

A World Trade Organization panel found that the subsidies weren’t consistent with the WTO’s Agreement on Subsidies and Countervailing Measures. Brazil failed to meet the WTO’s demand to revise PROEX, and a WTO panel later gave Canada the authority to impose up to C\$2.1 billion in countermeasures against Brazil. Though Brazil amended PROEX to comply with WTO requirements, the program exists to this day.

Embraer’s rapid growth during the 2000s spurred additional fears that subsidies were being paid. In 2010, then-Senator Sam Brownback (R-KS) requested a U.S. International Trade Commission investigation of Embraer. As he stated in an August 24, 2010, speech in Wichita,

²⁸ World Trade Organization. *Report WT/DS46/R: Brazil – Export Financing Programme for Aircraft*, 14 April 1999, p. 14. Available at http://www.wto.org/english/tratop_e/dispu_e/46r.doc.

²⁹ European Commission Directorate General for Trade. “Examination Procedure Regarding the Brazilian Export Financing Programme ‘PROEX’ As Applied in the Regional Aircraft Sector,” 21 October 1999, p. 13. Available at http://trade.ec.europa.eu/doclib/docs/2004/october/tradoc_112174.pdf.

³⁰ World Trade Organization. *Report WT/DS46/ARB: Brazil – Export Financing Programme for Aircraft*, 28 August 2000, p. 9.

³¹ Jeziorski, Andrzej. “Fairchild Dornier challenges Embraer on interest benefits,” *Flight International*, 15 July 1998.

They've got 15% of the market space after a flat dead start in 2002. To get 15% of the market in that period of time, I don't think you can do without heavy subsidization by the Brazilian government.³²

To date, no investigation into this subject has been concluded.

CONCLUSION: IS U.S. MILITARY TRADE WITH BRAZIL A GOOD IDEA?

The confluence in recent years of rising Brazilian power, a politically strong Brazilian president, and U.S. preoccupation in other areas of the world provided Brazil new opportunities to act assertively on political, diplomatic, and economic fronts. Under President Luiz Inácio Lula da Silva, Brazil pursued a more independent foreign policy through which it repeatedly clashed with the United States.

But now that da Silva has left the political stage and a new leader, President Dilma Rousseff, has begun to formulate a new set of policies, the U.S.-Brazil relationship will evolve. There will be significant continuity, as Rousseff was da Silva's former chief of staff and hand-picked successor. But there will also be some policy shifts. For example, Rousseff has distanced herself from da Silva's policy on human rights in Iran. In a December 2010 *Washington Post* interview, she criticized Brazil's past abstention on a U.N human rights resolution, saying that "it's not my position" to remain silent on human rights abuses.³³

The path ahead is uncertain. Rousseff's past involvement with leftist and Marxist groups is cause for concern. Her political thinking was in part shaped by supporters of Fidel Castro's revolutionary ideology—such as French communist intellectual Régis Debray.³⁴ Rousseff is also said to support a statist industrial policy. As Brazil's president, she is looking toward the Chinese model on industrial policy,³⁵ and shows signs of adopting an increasingly active industrial posture.³⁶

³² Trimble, Stephen. "US senator, Embraer in dispute over business jet subsidies," *Flight International*, 7-13 September 2010.

³³ Weymouth, Lally. "An interview with Dilma Rousseff, Brazil's president-elect," *Washington Post*, 3 December 2010, Available at http://www.washingtonpost.com/wp-dyn/content/article/2010/12/03/AR2010120303241_pf.html.

³⁴ "Dilma Rousseff," *CBC News*, 31 October 2010, Available at <http://www.cbc.ca/news/world/story/2010/10/29/f-brazil-dilma-rousseff.html>.

³⁵ Leahy, Joe. "Brazil looks to China for industrial policy," *Financial Times*, 11 April 2001.

³⁶ See, for example, "Vale: signs of growing resource nationalism," *Financial Times*, 3 April 2011.

In particular, Rousseff has worked to replace CEO Roger Agnelli at Vale, the world's second-largest mining company. Agnelli was targeted because Vale focused on cutting jobs as a means of controlling costs; because the company had ore carriers built in Asia instead of Brazil; and because it tried to minimize taxes and royalties that it paid.³⁷ In other words, Agnelli's policies did not seem to conform to Rousseff's vision for industrial policy.

The replacement of Agnelli raises a number of fundamental questions. Is there a possibility that the Brazilian government could wield similar influence over Embraer corporate leadership that would affect its ability to execute its contractual obligations? Would the fear of such negative influence impact corporate decision making? Are there situations in which political considerations could move the Brazilian government to stop shipments of aircraft or components to a particular country? Is a government-influenced corporation that produces aircraft in a country with demonstrably negative views of U.S. foreign policy a reliable source of combat aircraft for the U.S. Defense Department?

The unclear signals sent out thus far justify a cautious U.S. approach to developing defense trade with Brazil. Brazil's mid- and long-term foreign policy orientation is too uncertain at this point, and history suggests that the prospects for a close alliance are not good. Moreover, the future course of the relationship between Brazil's government and its private sector is unknown. Trade that could strengthen Brazilian defense industry while possibly jeopardizing U.S. producers should be subjected to appropriate scrutiny.

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³⁷ "Vale: Roger Agnelli vs. Dilma Rousseff," *The Business of Mining*, 28 March 2011, Available at <http://thebusinessofmining.com/2011/03/28/vale-roger-agnelli-vs-dilma-rousseff/>.

See also:

"Brazilian government wants to sack CEO of the country's largest corporation," *MercoPress*, 25 March 2011, Available at <http://en.mercopress.com/2011/03/25/brazilian-government-wants-to-sack-ceo-of-the-country-s-largest-corporation>.

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