

Can Brazil be a Model of Development for Russia?

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Can countries overcome the problems associated with natural resource management through the implementation of good policies? A comparison of Russia and Brazil shows that indeed policymakers can make a difference. These two countries started in relatively similar positions in the early 1990s, but they have now evolved to the point where Brazil is in a much stronger position than Russia.

Russia and Brazil began the 1990s facing great challenges, but with considerable opportunities for increasing their standards of living. Brazil was emerging out of a period of military rule that had left the economy in shambles, while Russia had dissolved the Soviet Union and was adopting a market economy and greater political freedoms. Both countries had industrialized but remained burdened by widespread poverty, deficient infrastructure (including roads, ports, communications networks, and healthcare), and extreme social stratification. Of course, there were important differences. For example, Brazil possessed a small but well-educated technocratic elite while Russia had achieved a higher level of education for its masses. This distinction is important since Brazil's policies were designed to favor its well-educated elite, while Russia had the potential to achieve greater levels of productivity gains based on its large, skilled work force, which would benefit from market competition.

Today, the prospects for Brazil seem much brighter than they do for Russia. Since Soviet times, Russia has been a major energy exporter, while Brazil has been quickly developing its extensive energy resources. While Russia's oil production has remained largely flat in recent years, Brazil is soon expected to reach petroleum independence and to become a major exporter within the next decade, thanks to its major investments and large energy reserve additions. Brazil's recovery from the global economic crisis has been robust, while Russia's appears more uncertain. The central factors in Brazil's relative success have been its treatment of foreign capital, the way in which it has defined the role of the state in the energy sector, its efforts to combat corruption, the successful implementation of an independent regulatory regime, and its efforts to stimulate innovation.

Foreign Capital

Brazil adopted macroeconomic reforms in 1994, and its economic situation has been relatively stable since then. Accordingly, it has become a magnet for foreign direct investment, attracting a strong portfolio of international partners. Property rights are considered relatively secure in Brazil.

In Russia, by contrast, international energy investors have faced a number of problems. The Russian government forced Shell to sell a stake in its Sakhalin-II liquefied natural gas project to Gazprom by exerting pressure on the company through numerous environmental inspections, a problem that disappeared once Gazprom became a key partner in the project. Similarly, Gazprom has prevented BP and its Russian partners from developing the Kovykta natural gas deposit in Eastern Siberia since it does not want to give up its pipeline monopoly, ultimately forcing them to declare the project bankrupt in the summer of 2010. Questions about property rights and the uncertainties of the natural gas market have also led to delays in the development of the offshore Shtokman reserves.

The Role of National Oil Companies

The two governments have treated their energy companies differently. Brazil has forced its state-controlled Petrobras company – of which the government has a 55 percent controlling interest but only 33 percent of total shares – to compete with foreign companies to develop upstream assets in the country. This exposure has forced the company to improve the way it operates and prevented it from relying on state protection. However, since it has intimate knowledge of the deposits located on Brazilian territory, Petrobras has an advantage over the international energy companies coming to work in Brazil. Beyond forcing Petrobras to compete, Brazil's technocratic elite defends company interests rather than state ones so the company does not serve as a cash cow for politicians worried about preventing domestic unrest. Much of its income is reinvested in energy development projects. Today, Petrobras is considered to be one of the best run oil companies in the world, and the company is a technical leader in areas such as deepwater offshore drilling.

In Russia, the national champions Gazprom and Rosneft are much less efficient than foreign competitors. Gazprom, for example, pays much more to build pipelines than do foreign companies while Rosneft is less efficient than Yukos, whose assets it took over when the Russian government put it out of business. Gazprom and Rosneft have a heavily favored position at home and do not face foreign competition on their own territory. Although Gazprom pays less in taxes to the Russian budget than do Russia's oil companies, it makes a significant contribution to the leaders' political interests by providing extensive natural gas subsidies to Russian industries and households. While gas prices for domestic consumers have risen in recent years, they still fall far short of international levels. Plans to force domestic consumers to pay international prices by 2011 have been put on hold to avoid inflicting pain on the population, which could potentially lead to political instability.

Corruption

In Transparency International's Corruption Perceptions Index for 2009, Brazil ranked 75th with an absolute score of 3.7 on a 1-10 scale. Russia ranked 146th with a score of 2.2. Brazil has had a long and difficult battle with corruption. The new democracy that emerged after years of military rule placed its hopes in a young, charismatic leader named Fernando Collor de Mello, who served as president from 1990 to 1992. Collor opted for a "centrist" approach, denouncing the abusive bureaucracy and massive corruption prevailing within government institutions. His administration was going to be a model of transparency and honesty. Collor's policies seemed to work in the beginning, but his early successes only masked deeper problems that the young leader was unable or unwilling to address. The practices and attitudes that had built up over the decades proved resistant to change, and most of the initial progress made under Collor collapsed in 1992 when he was impeached as a result of corruption and influence-peddling scandals.

The traumatic effect of the Collor impeachment had a positive impact. It forced the political elites to focus on reforming institutions and addressing the long-term ills that resulted in Brazil's inability to meet its economic and geopolitical potential. Business elites were reluctant to see the return of the military, which they considered economically unskilled and partially responsible for the massive debt burden that was affecting Brazil. The new president, Fernando Henrique Cardoso, the former finance minister, introduced key reforms that dramatically improved the situation: a new currency, opening the economy, and ending Brazil's import-substitution policy. Microeconomic reforms aimed to improve efficiency, foster market competition, and capture revenues from the sale of state assets. While the government did not privatize Petrobras, it set up strong institutions that could manage the industry. Cardoso's successor, Luiz Inácio Lula da Silva, largely preserved his policies.

In the area of corruption control, Russia has followed a much different path. During his eight years as president, Vladimir Putin never made much progress on the issue. Upon coming to power, Dmitry Medvedev announced that fighting corruption would be central to his administration, but after two years in office, he also recently admitted that he has made little progress. In contrast to Brazil, Russian policymakers have refused to institute fundamental institutional reforms, opting instead for half-hearted solutions such as poorly-enforced efforts to force bureaucrats to publish their incomes. Russia has also refused to implement the kind of democratic reforms that have accompanied Brazil's economic efforts: contested elections, a free media in the vital sphere of television, and an independent court system.

Regulation

Although Petrobras continues to possess extensive insider knowledge, the Brazilian government has set up an extensive regulatory system that is separate from the company. A key part of Brazil's success was establishing in 1994 the National Petroleum Agency, which had the authority to manage the country's oil assets. The regulator made it possible to end Petrobras' monopoly and open Brazilian deposits to

foreign bidders. Since the opening of Brazil's oil sector, the country's reserves and production levels have been increasing.

By contrast, the Russian government and its state-owned energy companies are deeply entangled in a web of conflicting interests. Gazprom is perceived as Putin's personal project, and the prime minister maintains a tight grip over its operations. Many of Putin's close associates and long-time friends have personally benefited from links to the gas monopoly. Deputy Prime Minister Igor Sechin, who is in charge of energy issues for the state, is also the chairman of the board of Rosneft. Before becoming president, Medvedev served as chairman of the board of Gazprom. Because of these numerous personal and informal ties between the state and energy companies, there is essentially no oversight or objective regulation of them.

Innovation

The Brazilian government has proven to be effective at innovation. In the mid-1970s, during the first energy crisis, it actively supported the development of sugarcane ethanol as a substitute for gasoline in order to reduce its dependence on Middle East exports. This program continued during the 1990s (a period of low oil prices) as a source of employment and income support to the powerful sugar lobby. In recent years, the ethanol program has become even more important. Demand for ethanol surged due to increases in oil prices, but also due to technical developments in the automobile industry, which allows drivers to use either gasoline or ethanol in locally manufactured cars. Additionally, concerns about climate change are offering the opportunity for exports of ethanol and Brazilian ethanol technology to international markets.

In addition to Brazil's ethanol capacity, the national oil company Petrobras developed its ability to explore and produce resources in deepwater areas where many of Brazil's resources are located. The keys to the company's success were its strong financial position supported by a fast-growing domestic market, a technocratic elite with international experience, significant levels of financial independence from politicians, and in-house technical capabilities.

Since Tsarist times, the Russian government has sought to implement policies that would stimulate innovation in the country. Medvedev has enacted the latest version of this strategy through his efforts aimed at modernization. So far, however, his policies have resulted only in a new buzzword for the elite. Efforts to develop new technologies, such as in the nanosphere or sponsoring a Russian version of Silicon Valley, are just getting started. In relation to energy, Shell has brought new liquified natural gas technology to Russia and BP has been successful in spurring production at old oil wells, but it is not clear if this technology transfer will be enough to help modernize the Russian energy sector. At the same time, domestic energy consumption is extremely inefficient, but there has been little effort to implement new energy-saving technologies.

Challenges for the Future

While Brazil could serve as a model for development in Russia, it faces many challenges today. The government must overcome pressure to use the funds generated from its growing energy wealth for populist purposes. Another risk is that the country could become overly dependent on fossil fuel production and succumb to the “Dutch Disease” (the notion that exploiting natural resources leads to a decline in other export sectors). As Petrobras’s economic weight increases in the economy, the added responsibilities will put enormous pressure on the company. In particular, maintaining the delicate balance between its cherished strategic independence and risk-averse politicians’ desire for control will become more challenging.

The key lesson that Russia can take from Brazil is the need for improved institutions, both for controlling its energy wealth and using it in effective ways. Russia has yet to find an effective model for working with foreign companies over the long-term. While many countries have state-owned energy companies, Russian companies work in a manner that does not meet competitive levels internationally. Similarly, Russia has not put in place the kind of reforms that would allow it to regulate its energy sector so the benefits accrue to the state rather than to powerful individuals. The results of its well-publicized efforts to fight corruption have been anemic, as have efforts at innovation so far. The Brazilian example shows that better policies in Russia could help the country achieve results that are more in line with its potential than is currently the case.

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