

Oil euphoria puts Lula's legacy at risk

By Norman Gall

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Brazil is flying high. Having emerged unscathed from the financial crisis, its economy has been growing at 9 per cent a year. Its hugely popular president, Luiz Inácio Lula da Silva, now in his last months in office, seemed set to retire with a chorus of praise – until he plunged into the complications of **deep-water oil**. Just as Icarus saw his wings of wax melt as he flew too close to the sun, so Mr Lula is risking his legacy as controversies multiply over his petroleum policies.

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The April blowout of **BP's Macondo well in the Gulf of Mexico** dramatised the difficulties of oil exploration in deep waters. The next phase in that drama could come in giant fields recently discovered by **Petrobras**, Brazil's state-controlled oil company. They lie 7,000 metres below the Atlantic, beneath unstable salt beds up to 2,200 metres thick, far deeper than the layer of salt capping the Macondo.

These discoveries come with formidable production problems. But they also fed Mr Lula's geopolitical ambitions, while fuelling election fever in the months before his successor is chosen in October. Banned from re-election by the constitution, Mr Lula is using the image of Brazil as a rising oil power as a political weapon, invoking feelings of triumphalism to help his Workers party to victory.

This possible rise to power is not illusory. The Santos Basin may hold anything from 9bn to 14bn barrels of oil and gas, which could double Brazil's reserves, placing its holdings far above the likes of Shell and BP. The politics of the discovery are awkward, however. Mr Lula's favoured candidate – for whom he is campaigning ardently, and who is favourite to win – is his former chief of staff **Dilma Rousseff**. But as well as being an economist and former guerrilla fighter, Ms Rousseff also chaired the Petrobras governing board just as technicians were drafting the legislation that granted the company a virtual monopoly over the new discovery. Economic advisers to the Brazilian senate have since found "myriad unconstitutionality" in the proposals, exposing it to litigation.

Safety issues are raising further concerns. While the BP blowout was 120km from shore, the Santos Basin finds are up to 350km from the Brazilian coast. This poses daunting logistical problems. If a big accident were to occur so far out, neither Petrobras nor Brazil's navy nor private shipping could mount an emergency effort on the scale seen in the Gulf of Mexico.

Mr Lula called such exploration risks "negligible" while oil euphoria bred in the political class an illusion of limitless resources on the horizon. Members of Brazil's congress fought furiously to divide future oil royalties among states and municipalities. But even if Petrobras could overcome these safety difficulties, its ambition is pushing too fast, on too great a scale and with too high a profile.

In recent decades the company has become a pioneer in deep-water production, and is now among the most successful of the state-owned companies that control the bulk of world oil supplies. Its ability to develop a world-class corps of technicians has been especially impressive, not least in a country short of basic skills. But it is moving now to a new level of enterprise, in which the financial and technical challenges are so great that they will severely test the capacities of Petrobras and Brazilian suppliers.



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In the first instance current plans provide a new state-owned company, Pré-Sal Petróleo, with veto powers over all operating decisions. Planned legislation designates Petrobras as the sole operator of all future oil concessions in the area, with a 30 per cent minimum stake. But such an expansion would spread thin its financial and technical capacity, while shortages of trained personnel could expose it to safety issues. Indeed, the company's president has stressed that it lacks sufficient technicians to carry out such ambitious projects.

In the medium-term, Petrobras plans a \$224bn (€171bn, £141bn) five-year **investment programme**, requiring \$96bn in new financing. This will include floating the company in September – probably the largest **share offer** in history, worth at least \$25bn – alongside new borrowing. But this will strain Brazil's government, which has already borrowed heavily to fund both Petrobras and the national development bank, BNDES, which in turn is lending even more to Petrobras and its suppliers. The company's financial needs are now so great that they dwarf the meagre investment capacity of Brazil's federal government, in a country that desperately needs to spend more on infrastructure and education.

The risk for Mr Lula is that these requirements will take money away from other priorities. Some \$80bn is needed to prepare Brazil for hosting both the 2014 World Cup and the **2016 Olympics**. A bullet train between Rio de Janeiro and São Paulo – talked about since the 1980s but unlikely to be ready for the Olympics – will cost \$18bn. Another \$15bn, meanwhile, would finance **Belo Monte**, a giant dam in the Amazon talked about since the 1970s. Having already delayed its stock offering once, Petrobras's capitalisation plans remain mired in technical and legal problems over how to price the newly discovered oil that the government plans to use to increase its stake. This is causing controversy in financial markets, and could ultimately have political consequences.

When Mr Lula took office in 2003, he had the wisdom to recognise that Brazilians would not accept a return to the chronic inflation that had impaired their welfare for decades. Critics now argue that the surge in recent government spending, along with the financial controversy that has surrounded the recent oil discovery, may signify a regrettable return to the past. If Brazil does not straighten out its priorities, Mr Lula may soon find his reputation sinking as deep as the oil deposits that have so enthused his country.

The writer is executive director at the Fernand Braudel Institute of World Economics in São Paulo

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Marty | August 25 11:51pm | [Permalink](#) [Report](#)

We do not like Dilma - she is a fake. The polls that show she is ahead are made between ignorant and poor people up in the Northern are of town. Whoever has an IG over 50 knows she is nearly illiterate, does not connect her ideas, she is in the govt because she killed for them. She was a guerilla. She is being rewarded. But she was never elected. We do not like her at all.

The Philosopher | August 15 12:28am | [Permalink](#) [Report](#)

It would tragedy for Brazil and all of South America if Brazil's oil returned of fiscal imprudence and inflation.

debora_anacleto | August 13 8:40pm | [Permalink](#) [Report](#)

i love how reasonable Mr Norman Gall sounds. to make it seem like the finding of a valuable natural resource could actually "signify a regrettable return to the past..."

=DDD that's funny...

to the Brazilian population and specially to our grad and college students:
 there is A LOT of work to be done, let's do it! and remember that the Mr Norman Galls out there have absolutely no power and that they represent nothing but an opinion

Felipe-DL | August 13 3:19pm | [Permalink](#)

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The article, mainly in its part concerning Petrobras, refers to a well-known dilemma as if it had an obvious answer. The problem, though, is that it wouldn't be a well-known dilemma to begin with if it had an obvious answer. Yes, Petrobras' plans are ambitious and high-scaled, and it does present significant risk. What the author seems to have missed is that not having ambitious and high-scaled plans also pose significant risks - you might just get eaten by competitors who dared more than you did and sink in your safety-mediocrity boat (or rig). Indeed, the latter risk might be lower than the previous, but so is the possible benefit. Therefore it's a matter of profile, you can either be conservative or aggressive. Personally, I'd pick the latter at anytime.

Furthermore, one could wonder what "ambition with too high a profile" means here. A few things come to mind, none of them sound reasonable, and some are quite shameful.

Yet the text seems to oversimplify the complex relations that drive inflation. As the author undoubtedly knows - but for some reason suppressed -, inflation depends on a extensive list of features, amongst which, "financial controversy surrounding a recent oil discovery" is likely to be the least relevant - if any relevant at all. Besides the article gives us the impression that the Estate doesn't know the inflation problem or/and isn't doing anything about it, what is simply not the case. In fact, few Estates have done so much to deal with this problem over the past 20 years - government after government -, and continues to do. If having the sky-high interest rates Brazil has - and kept for most part during one of the worst world financial and demand crisis mankind has known for a long time - doesn't qualify as a strong (and some would say radical) measure to restrain inflation, I'm curious about what on earth would.

Last but not least, this catastrophic tone does nothing but discredit the good arguments - such as the critical need for infrastructure. The Icarus analogy is something we could have done without, as well as the "this is causing controversy in financial markets, and could ultimately have political consequences" - pretty much anything causes controversy in financial markets, controversy is their very nature. And even the glance of an eye can ultimately have political consequences, thus this apolyptic approach to an ordinary fact could've been spared.

gumuciojc | August 12 11:56pm | [Permalink](#)

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Brazil has higher priorities, that are not new, like education, infrastructure and honesty at all government levels Federal and States but Lula is the head of an populist government with a corrupt party that only cares of personal gains and unfortunately the opposition is not much different.

Think that Lula is going to make Brazil loose the big opportunity to really became a first world country, instead of investing in what the country needs to continue growing, he only thinks in what is going to make him "look good"

In this part of the world we have already seen this happened, Peron's legacy -corruption and personal gains- is responsible for the actual situation of Argentina.

Helga Hoffmann | August 12 9:17pm | [Permalink](#)

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Norman Gall knows Brazil very well. Unfortunately he is right in his comment about the government's handling of the recent Brazilian oil discoveries.

danilo_barbosa | August 12 6:18pm | [Permalink](#)

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Well its really a matter of priority, but i don't see any problem.

Brazil can postpone deep-sea exploration and the oil will remain there...

dt | August 12 3:25pm | [Permalink](#)

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Lula is a classic case of a populist politician interested only in strengthening trade union prescence, aiding his party's crooks in their hefty spending programs (usually based on large figures instead of quality - he has recently sanctioned a law allowing questionable project spending to go through the TCU unquestioned (Tribunal de Contas da União - The court that oversees that public spending is not being diverted, swindled or simply stolen).

In fact, the TCU is one of the few examples of an attempt to add transparency to the whole spending projects. In fact, only 35 projects (16% of the total in Lulas growth programme [PAC]) passed through the evaluation unscathed. Almost all projects have some form of irregularity.

Mr. Gall stating that Lula's legacy was unscathed until recently illustrates a lack of research by the author. Lula is just another corrupt politician riding a wave of unsustainable growth (best known as the chicken flight in Brazil). His 8 years in office are covered in questionable - if not blatantly immoral, unethical and frequently illegal actions, masked by his humble origins (popular amongst journalists) and lack of education. Lula popularity stems simply from the fact he came from "below", aided by his high charisma.

marcosamatucci | August 11 11:55pm | [Permalink](#)

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Yep. And is bad advertising to the ethanol program, one of Brazil's masterpieces.

luizcsleao | August 11 10:30pm | [Permalink](#)

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I am not sure about the author. Fernand Braudel Intitute has many oppositors to Lula government. I can not trust in this article.

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