

## What's Wrong with Brazil's Once-Thought-Indestructible Petrobras

Written by B. Michael Rubin  
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It is widely believed that the countries which best manage their energy needs today will have the most productive economic futures. Until now, Brazil has been among an elite group of countries facing an optimistic energy future. For most of the past decade, Brazil has been "energy independent", limiting its total consumption of energy to what it could produce. (In fact, Brazil has imported some oil and gas, but at approximately the same levels it was exporting.)

However, recently the news regarding Brazil's energy future is not as healthy. Oil production is falling at Petrobras. In 2012, its production fell 2%, the first such decline in years. Compounding a fall in oil production, Petrobras has also been forced to import gasoline, exposing Brazil to the fluctuations in the global energy markets. Even the nation's ethanol industry, once envied as a model of renewable energy, has had to import ethanol from the United States.

Brazil's demand for gasoline surged about 20% in 2012, reflecting a car-manufacturing industry that has boomed, partly as a result of a government stimulus through lowered taxation. José Carlos Cosenza, a Petrobras executive, has warned that Brazil may need to import large amounts of gas for almost another decade. Gasoline demand is expected to climb even higher as Brazilians buy more cars.

Petrobras still lacks enough refineries able to process crude oil, forcing it to buy increasing amounts of gasoline from abroad. And it is still losing money on gasoline imports as the government limits increases in gas prices to keep inflation from accelerating in a slow-growing economy.

Five years ago, Brazilians were celebrating the discovery of huge amounts of oil in deep-sea deposits about 250 kilometers off the coast of Rio. The discovery, originally named Tupi, but now called the Lula oil field, was the largest oil discovery in the Western Hemisphere in the last 30 years. Many energy experts predicted the discovery would launch Brazil into the top ranks of global oil producers.

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Nevertheless, today Petrobras is struggling. Energy experts cite several reasons why the giant energy company is not performing up to expectation. First, there's Brazil's economy. In 2010, GDP growth was at 7.5%, while in 2012 it slowed to less than 1%. Even in Latin America, countries like Peru and Mexico are outperforming Brazil. With a sluggish economy comes lower tax revenue, which means less investments from the government available for Petrobras.

Second, thanks in strong part to the Lula oil field, huge additional investments in Petrobras are needed at this time. The rich new oil deposits are located in deep-water locations, requiring special drilling equipment that Petrobras doesn't have.

Also, greater safety measures, which require additional investment, are necessary to excavate these deep-water deposits in order to avoid the kind of disaster that BP faced in the Gulf of Mexico in the US with its Deepwater Horizon oil spill. That explosion and subsequent spill cost BP the lives of 11 oil-rig workers and was the largest accidental marine oil spill in the history of the industry.

Besides the loss of life, BP has already paid billions of dollars in fines to the US government and still faces the possibility of billions more resulting from civil law suits from fishermen and home owners affected by the giant spill in the Gulf.

The third element that is crippling Petrobras is the current government in Brazil, which has demanded that Petrobras acquire all the necessary new equipment for excavating the oil from the Lula oil field with Brazilian technology. While this equipment is readily available from other countries, the government believes it's better to produce the equipment inside the country, even if it takes longer and costs more.

Thus Petrobras is now being forced to buy ships, oil platforms, and other equipment from Brazilian companies. But these ventures have struggled with large cost overruns, sometimes delivering equipment or vessels late or not at all, cutting into Petrobras' hopes of meeting ambitious production targets.

As a result, Petrobras has been placed in an impossible position. Not only have the Lula oil field operations yet to go into production, but other major projects are being delayed while the company focuses its financial and technical resources on the Lula field.

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"Petrobras was once thought indestructible, but that is no longer the case," said Adriano Pires, a prominent Brazilian energy consultant. "Petrobras is now a tool of short-term economic policy, used to protect domestic industry from competition and fight inflation. This disastrous process will intensify if it is not reversed."

President Dilma Rousseff, like her predecessor and political mentor, Lula, has relied heavily on state companies like Petrobras to create jobs and spur the economy. As a result, the president and her top advisers argue, unemployment remains near historic lows in Brazil, an approach to economic management that contrasts sharply with Europe and the United States, where high unemployment is crippling economic growth.

Dilma notes that Petrobras is building new refineries, pursuing offshore oil, and buying most of its equipment from Brazilian companies, all of which have created tens of thousands of jobs and delivered some tangible political benefits.

The government's relationship with Petrobras has not always been so close. In the 1990s, the government ended Petrobras' monopoly. The company remained under state control but it became a hybrid organization, both state-owned and private, like a few other organizations in Brazil, such as Caixa Econômica, one of Brazil's largest banks.

As a result, in the last decade, Petrobras had been forced to compete with foreign oil companies. However, after Brazil made its deep-sea oil discoveries at Tupi in 2007, the government pushed Petrobras firmly in control of the new oil, signaling a return to an earlier philosophy of monopolistic energy policy.

An additional problem Petrobras faces is that the international energy industry is changing, especially in the United States, shifting towards extracting oil and natural gas from onshore shale formations rather than ocean drilling. Many oil companies now prefer ground extraction to ocean oil wells after the BP disaster.

Brazil is thought to have large shale reserves itself, but the government remains focused on its costly deep-sea mega-projects, and thus Petrobras is falling behind in this new onshore

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technology for oil exploration.

"The United States is redrawing the global petroleum map, while in Brazil euphoria [after the Tupi discovery] has given way to inertia," Folha de S. Paulo said in a recent editorial.

Describing the accumulation of problems at Petrobras, Exame, Brazil's top business magazine, bluntly accused the government of "destroying Brazil's largest company," accompanying the claim with an illustration of a fuel dispenser from a gas station in the shape of a noose.

Maria das Graças Foster, the chief executive of Petrobras, has been exceptionally frank about the company's problems. In recent conference calls with analysts, she said that oil production should remain steady this year or perhaps even decline slightly again. By 2020, the company expects to double overall production to 4.2 million barrels a day.

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