

Institutional structures of brazil and china economics essay



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There are a number of factors that multi-national corporations ought to consider before investing in another country. The challenges that are faced vary from country to country. In some cases there are similarities within the institutional structures of these countries that may attract corporations to take advantage of the favorable factors. On the other hand some instructional structures are capable of limiting the policy alternatives available to investors and other policy makers. The control in power among government organizations such as the legislative, judicial and executive makes it difficult for the policy making process to be reviewed.

This paper seeks to analyze and discuss five areas of the institutional structures of Brazil and china that are likely to influence global corporations like OPEC to invest in the petroleum industry of another country. A discussion of the comparative attractiveness of these markets is also presented after the assessment of the two countries. A brief back ground of the two countries is also presented. A logical conclusion is drawn from such assessment at the end of this paper.

overview of Brazil

With the exploitation of large natural resources and a large labor intensive economy, Brazil has risen to the position of being the leading economic power in South America as a major emerging economy. Revenues from the production and supply of oil have made a significant contribution to the development of the economy. Petrobras (a major oil producing company in Brazil founded in the year 1953) has established itself as the biggest oil company in the Latin America in terms of revenue and market capitalization; according to the rankings from Latin Business Chronicle, Petrobras 2008 <https://assignbuster.com/institutional-structures-of-brazil-and-china-economics-essay/>

revenue was 118.3 billion. While the company (Petrobras) has withdrawn itself from being Brazil's legal monopolist in the petroleum industry in 1997, it continues to play a significant role as a major oil producer, with production exceeding 2 million barrels of oil per day. Information presented on CIA-world fact a book show that in 2008 Brazil's estimated oil production in barrels of oil equivalent per day was 2.422 million.

The country is governed under the 1988 constitution of amendment, of which it is presently being run by the federal republic (government type). The country's president (leader of government) who is elected into office by the highest votes can serve a four year term (and may do so on two terms), has both the positions of the head of state and head of government.

Brazil has an increasing economy based primarily on financial, service, manufacturing and trade (Britannica concise encyclopedia, 2010). With an increasing and developing agricultural, mining, manufacturing and service sectors, Brazil is placed at the top of all the countries within South America. This has allowed the country to accomplish a well established position in the global market and economy. According to a report produced by the World Economic Forum, the Brazilian economy was ranked as the top country in rising evolution of competitiveness in 2009.

Brazil possesses a large mineral wealth comprising of iron ore, tin, quartz, industrial diamonds, gem stones, gold, uranium, bauxite and platinum. The newly found offshore oil and natural gas deposits can place the country in the position of being a major gas and petroleum producer. The country also has a very large food processing and the principal manufacturing industries

produce of products such as shoes, chemicals, steel, aircraft textile and machinery. The main source of Brazil's electricity comes from water power, and it has a great untouched potential for hydroelectricity, more so in the Amazon basin.

Brief overview of Russia

Russia has gone through a period of industrialization since the disintegration of the Soviet Union (in 1991) shifting from an internationally-isolated, predominantly planned economy to a market-oriented and internationally-integrated economy. The economic restructuring and development process which began in the 1990s has witnessed the nationalization of most industry, with the distinct exclusion in the energy and security-related sectors. Today, Russia has been experiencing significant economic development as one of the major emerging market. In addition, Russia has a favorable balance of trade where exports exceed imports in a significant way. According to CIA-the world fact book, Russia's estimated exports for 2008 and 2009 are 471.6 billion and 295.6 billion respectively, whereas their imports for the same period are 291.9 billion and 196.8 billion respectively. Russia's Petroleum industry is another major contributor to the economy and is one of the biggest oil producers in the global market. According to a June 2009 report present by the Energy Information Administration, Russia is ranked the 2nd largest oil producer with the production of 9,677 thousand barrels of oil per day. The report also ranked Russia as the fourth biggest consumer of petroleum in the world with consumption of approximately 2,811 thousand barrels per day. As it relates to oil export, Russia is ranked as the 2nd biggest net exporter) with 6,866 thousand barrels per day.

The government type of Russia is a Federal Republic which basically means that the country has a federation of states run by a Republican type of government. This type of government is comprised of both a President and a Prime Minister that jointly runs the country's affairs. The President holds the position of head of state while the Prime Minister holds the position of head of state; the Executive authority is carried out by the government and the Legislative Authority is carried out by both the government and the two chambers of the Federal Assembly of Russia. The safe guarding of property rights issue has continued to be an area of serious concern while the strong state interference in private sector continues to be a norm. Russia's industry is mainly divided between internationally competitive product producers. In 2009, Russia was the world's biggest exporter of both petroleum and natural gas and was ranked in third spot as the biggest exporter of steel and main aluminum.

In order for businesses to conduct foreign investments there are a few risk factors that can serve as barriers for investments. These risk factors could undermine growth and economic stability and they should be taken into consideration so that businesses would remain profitable and have sustainable market share in this competitive global era. Every business transactions have some level of risk. However, when business transaction takes place across global borders, additional risk is prevalent as oppose to domestic transactions. This section, examines the stability of both Brazil and Russia as it relates to the potential investment of Oil Industry. In order to compare and contrast both countries on its stability, considerations have to

be given to the Political, Economic, Regulatory and Technological environment.

Compare and contrast Brazil and Russia as it relates to political stability

Brazil has a Federal Government type meaning their political environment is made up of a number of self-governing states united by a federal government (Babylon translation, 2004), whereas, Russia on the other hand is made up of a Constitutional Federation (Federal Republic). The issue here is whether government's action could affect the profitability of investing in Brazil or Russia. Brazil is a stable government who is open to the idea of foreign investors. " It is the largest foreign direct investment recipient in Latin America, attracting an estimated USD 42 billion in 2008" (United Nations report). Although Brazil is considered as friendly or appropriate environment for investment, the government's implementation of high level taxation and regulatory requirements exist. Brazil has a cooperate tax of 34% as compared to Russia 20% (Brazil income taxes 2010). As a result, conducting business in Brazil as compared to Russia with taxation as the variable makes Russia more of an attractive market since businesses in Russia will have more disposable earning for expansionary purposes of the oil industry. The level of corruption in a country has far reaching ramification on investments and on the doing business climate. According to Transparency International (2010) which gives corruption perception indices on a scale of 1-10 (1 being highly corrupt and 10 being free from corruption), Brazil has a corruption perception index of 3.5 whereas; Russia has a corruption perception index of 2.3. Hence, Russia highly probability of

investors in the oil industry being subjected to unfair business practices than that of Brazil.

Compare and contrast Brazil and Russia as it relates to their Regulatory stability

According to Bloomberg's report (2008), the Brazilian economy grew at the fastest pace since 2004 and in sync with standards and poor's report the country is expected to maintain annual growth up to 4.5%. This type of economic growth gives credit to the country for potential investment. Thus, the previous year Brazil recorded a record high of \$34.6 billion foreign investment. This amount of foreign direct investment together with a tripled export rate will cover Brazil's current account deficit (Standard and Poor's, 2008). Brazil's stable economy has drawn investors and trade agreements between Brazil and other countries. Russia on the other hand, economy has been contracting due to falling oil prices and trade disputes with neighbors. This has resulted in Russia being the first G-8 nation to be downgraded since the start of the global economic crisis. Russia has been struggling with rising inflation, high unemployment, negative economic growth and social unrest which have become a disincentive for foreign direct investment including that of the oil industry (Walker and Robbins, 2009).

Compare and contrast Brazil and Russia as it relates to their Economic stability

As every other country Russia has regulatory system in place, however as a result of corruption, regulations are not enforced as to aid in the fair treatment of investors. The influence of governments on prices, bureaucratic inconsistency and other forms of government controls detour investments

in various sectors. The regulatory environment in Russia makes it difficult to start, operate and close a business. Bureaucratic procedures are drawn out and complicated. For example, obtaining a business license takes more than 18 procedures and 218 days (The heritage foundation 2010). Investment law is very subjective to federal law which allows Government a lot of discretionary control over foreign investment. That is to say, while investment laws speculate the national treatment or foreign investors, federal law is given the prerogative in the protection of the constitution and defense of state. In retrospect, the Russian government in 2006 introduced what is known as the strategic sectors law under which interests by foreign investors must be pre-approved by the Russian government which has been marred by corruption (Russia been ranked 147 out of 149 countries on transparency international index or 2008 and bribery being rampant), inadequate infrastructure and unreliable contract enforcement. All of these factors affecting the oil industry in various ways. The court system however, in Brazil has proven to be highly ineffective. This is due to lack of human resource and efficient functionary equipment, especially when dealing with issues pertaining to shareholder rights and claims. This comparison shows that both markets have varying weaknesses as it relates to regulatory systems. However, specific to oil industry, Brazil has a comparative advantage in that, the country has had regulatory stability for over 10 years of petroleum Law (Hale, 2009).

In addition to these, other factors influences the attractiveness of the market relative to the potential oil industry. Provided hereunder is the convertibility

of currency which is another deeming factor that can influence investment opportunities in Brazil or Russia.

Convertibility of Local Currency to Dollars

The convertibility of a country's local currency also plays an important role in further development of an economy. With the U. S dollar being the world reserve currency, developing countries would do well to have a close, if not full convertibility rate to the U. S dollar. In Brazil the currency used is the Brazilian Real (R\$), also known as BRL. At present the exchange rate for Brazilian currency to the U. S dollar is 1. 82 BRL to \$1 U. S. D. Though not fully convertible, the Brazilian Real stands strong. Ever since 2003, the U. S dollar has fallen 50% against the BRL. The reason for the strength in the Brazilian Real is the fact that Brazil's exports surpass its imports. Thus more foreign currency comes in, than the BRL goes out. This can affect the Brazilian currency positively as a convertible currency would mean free movement of capital, which can help strengthen the economy. Oil is in great demand all over, for it has a vast number of uses. If the oil industry were to come to Brazil it will yield much higher profits due to its close conversion rate to the US dollar of 1. 82 BRL to \$1 U. S. D as mentioned earlier. As of 2009, Brazil had the second largest oil reserves in the region of South America, of 12. 6 billion barrels as was proven by The Oil and Gas Journal (OGJ). 2. 4 billion barrels of oil was produced in Brazil each day and continued to rise throughout the years. With increases such as these, the Short-Term Energy Outlook forecasted as of September 2009, that oil production would reach around 2. 61 million and 2. 81 million in 2010. Brazil, in this respect clearly has high potential where the oil industry is concerned

and would prove to be a profitable area for investors wishing to position their industry in the country. However, investors must still be cautious. Although Brazil is high on foreign exchange, in order to sustain this level of foreign currency coming into the country, and to deter inflation of their currency, trade barriers and the high tariffs are placed on some goods to prevent or minimize imports. Taxes are also very high and are placed on all citizens in the country to cover government spending. So at the end of the day a heavy amount of a business's profits would go towards paying taxes. So while an oil industry may work well in Brazil, there are other areas of concern that investors must take into consideration before selecting the country as a target market.

Russia on the other hand has achieved full convertibility of its currency since the year 2006. Russia's currency uses the ruble or RUB. At present, its rate to the US is 1 RUB to 0.03 US dollars. This therefore opens Russia's economy to freer movement of trade and a major player in international financial markets (Encyclopedia.com, 2006). A fully convertible currency has gained Russia multiple benefits such as the opening of ruble accounts for both foreign and local investors alike and the advantage of investing in both foreign and domestic businesses. Russia is quickly becoming a globally established economy. However, there remain few problems with the Russian currency. According to The World's Favourite Currency Site, Russia's inflation rate, compared to the US Dollar, is near 6.5 percent, while the ruble has weakened to 33 rubles per US dollar. Russia, as the largest oil producer on the globe, can suffer greatly from fluctuations. This is because as prices rise and fall, so must the prices of oil change to reflect. This, as a result,

hinders the ability for the country to plan a proper budget for its economy and consequently, the ability to plan for expansionary purposes for the economy as a whole.

Comparing and contrast trade agreements & International relationship specific to the WTO and OPEC as it relates to the Brazil and Russia

As the result of globalization, international relations between countries have become increasingly significant, hence the reason why, the rules regarding international trade became necessary. On average 52.3% of Russia's total trade turnover takes place with the European Union which is also the biggest investor in Russia accounting for 75% of Russia's foreign direct investment. Notwithstanding this, Russia is the world's largest economy which is not part of the WTO and with Russia being the second largest producer of oil in the world, it is not part of OPEC. Russia's non-membership in these critical organizations limits its ability to play an active role in the decision making process as an emerging market. In the case of the WTO, despite recommendation for accession into the WTO by the EU and other members of the BRIC forum, Russia has failed to implement some of the necessary regulatory requirements as the leadership of the country has shown the lack of political will to do so. There have been years of rescheduling, timetabling and back and forth negotiations to ensure that Russia becomes a member of the WTO, however in June 2009 Russian Prime Minister Vladimir Putin made an appalling decision to abandon efforts for accession into the WTO. In retrospect, the development of Russia by exploiting opportunities made available through the WTO and its multilateral trade agreements is hindered.

Similarly, Russia's non-participation in OPEC has had far-reaching ramifications for the oil industry since it is not able to play a role in controlling the supply and price of oil. On the other hand, Brazil is a member of several international economic organizations as such as the WTO and WCO. The WTO is a global international organization which deals with trade between nations. Brazil's membership into the WTO represents the fact that the regulatory requirements of the WTO have been met by Brazil which allows for the exploitation of balance of rights and obligations and ensures that there is security and fairness as it relates to multilateral trade.

Traditionally Brazil has produced just about enough oil to aid in its local consumption. However in 2008 with the discovery of off shore oil deposits which may contain as much as 100 billion barrels of oil Brazil may become one of the worlds emerging oil exporters. In this regard Brazilian authorities have expressed the desire to become members of OPEC whenever it commences oil exports. This motive will stand to provide mutual benefits for both Brazil and the OPEC since the addition of Brazil as a member of OPEC will allow for the organization to have control over a larger percentage of the world's oil hence more influence on oil supply and by extension prices. Similarly, Brazil will now have influence over world oil prices as a member of OPEC. This gives Brazil a comparative advantage over Russia relative to the oil industry in that although Russia have been a major exporter of oil, it has not established relationships with other oil exporting countries to facilitate the regulation of oil supply, prices and corruption in the industry. Further, while Russia is suffering from quickly depleting oil supply Brazil has been able to locate new oil reserves resulting in more clout for Brazil on the

international scene as it relates to trade as a decision maker in the oil industry.

Market size and attractiveness

Both Russia and Brazil are part of the four emerging markets (BRIC) with great potential for economic growth. Brazil has a population of 192, 272, 890, ranked number four in terms of population size on the market potential index for emerging markets in 2009. Brazilians has a mean disposable income of USD 16, 208 with an emerging middle class. The level of economic growth has left some inequalities and therefore 75% of the population earns below the mean disposable income. The rapid growth of the middle class in Brazil has resulted in higher demands for oil and oil related products impacting positively on the industry. Growth of the upper/elite class is also evident with a 124% increase in average disposable income from 2002-2007 of USD 72, 932. These levels of growth have been complemented by increased government spending and a falling debt to GDP ratio. The decreasing amount of public and foreign debt stands to benefit the economy in terms of employment since government can spend more of its resources the capital side of the budget equation and in some cases less taxes are necessary to service recurrent expenditure and debt hence more disposable income is available to circulate in the economy. These economic conditions amongst many others are responsible for the position Brazil has established in the global market as one of the world's fastest emerging and most attractive markets. Russia's population stands at 141, 927, 297 as of 1 January 2010 with steady growth of the upper/elite class driving oil consumption to an all time high. The changing lifestyle of persons in the

upper class fueled by high-end motor vehicles has resulted in a ravenous demand for oil and oil based products. Russia's low debt to GDP ratio of 6.8% should allow for efficient distribution of wealth and steady economic growth. However because of the level of corruption there is inefficient distribution of wealth and the overdependence on the oil industry hinders the country's ability to compete in other areas. Russia also has the highest disposable income of emerging markets with 87% of per capita income being disposable, with projected increase of disposable averaged at 15% annually. There is a widening middleclass especially in Moscow which has a disposable income that is more than three times that of the national average. The average disposable income is \$ 1023. This comparison clearly shows why both countries are regarded as emerging markets and are generally attractive to investors. This will yield much benefit to the oil industry because of the increasing demand tied with improvements in the standard of living and disposable income. Russia however is confronted with the problem of depleting oil supply, hence, if demand continues to rise Russia oil imports will peak resulting in a steep fall in GDP. It should also be noted that the spread of wealth in Brazil is more equitable than that of Russia which creates a gap in class strata which is known to cause increases in indigent rates which leads to civil unrest in some cases.

Conclusions

The oil Industry is clearly very dynamic and is affected by several variables in the economy including: the type of government, economic freedom, regulatory systems, currency fluctuation and convertibility, general economic condition , trade and international relations, market size and

attractiveness and many other related factors. With Russia and Brazil being members of the BRIC forum of emerging markets and the concurrent peaks in demand for oil, efficient and prudent economic management should ensure the equitable spread of wealth which should stimulate economic growth. However limitations of governments and other related variables are impediments to the achievement of these noble dreams. Hence, based on the evaluation of critical areas in this paper it is conclusive that both Brazil and Russia presents opportunities for investment and in specific areas one may have a comparable advantage over the other. Clearly in generalization Brazil offers a more stable and predictable investment environment which hinges on its steady system of government with established trade relations and a regime prone to fighting corruption as opposed to Russia which have been marred by corruption at all levels and mismanagement in its oil industry. The emergence of future oil exporting potential by Brazil will further position Brazil to be one of the world's economic powers. While Russia have had some level of growth, much of it is not attributed to the efforts of its government system but rather to economic factors as a result of changing spending patterns. Our recommendation of Brazil as the choice investment market is relative to outlook from the perspective of the oil industry and may vary for other industries. It is arguable that based on the industry being examined and the economic variables under consideration that Russia may be found suitable for investment.