THE ROAD TO PRIVATIZATION: BRAZIL EXPERIENCE

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This article explores the privatization programs implemented by Brazil's governments since 1990.

On the verge of its 27th anniversary, Law 8031/1990, which instituted the National Denationalization Program (NDP), takes on fresh importance as the current federal government promises a new "wave of privatization" based on its Partnership and Investment Program (PIP).

Brazil's current president, Michel Temer - who took over the presidency after impeachment proceedings were filed against Dilma Roussefff - issued Provisional Measure (PM) 727/2016 to create the PIP in June 2016 while running the interim administration. The text says:

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"The PM therefore determines that the PIP will be made up of: (i) public infrastructure projects based on partnership agreements entered into by the federal government's agencies of direct and indirect public administration; (ii) public infrastructure projects that are delegated or supported by the federal government and are based on partnership agreements entered into by State, Federal District or Municipal agencies of direct or indirect public administration; and (iii) other measures instituted by the National Denationalization Program referred to in Law 9491/97".

The current federal government's efforts to rekindle the privatization process are praiseworthy. According to article 173 of Brazil's Federal Constitution, the state should only pursue business activities "when necessary to address issues of national security or relevant public interest". Created 29 years ago, the spirit of this constitutional rule has been ignored by a number of groups that have specific interests in the income generated by the extensive value chains established by state-owned enterprises.

Created in the 1940s, Brazil's first major state-owned enterprises – with the exception of Banco do Brasil (1808) and Caixa Econômica Federal (1861), which were set up in the 19th century – were founded to support Brazil's economic development, which was to be led by the state. As private sector manufacturing was still in its infancy, these enterprises were a quick solution to help boost Brazil's economic growth. The creation of state-owned enterprises peaked in the 1970s, the period known as Brazil's "economic miracle", during the military dictatorship.

However, in the two following decades, this process was reversed and denationalization began. What is called the "lost decade", between 1980 and 1990, sparked efforts to privatize Brazil's state-owned enterprises. During this period, marked by great social, political and economic upheaval, the state-owned business model become outmoded; the country faced uncontrollable triple-digit annual hyperinflation; Brazil's industrial base became obsolete and public accounts fell apart; and people saw their purchasing power reduced to ashes.

Brazil's denationalization process took shape and gained strength during the administration of Fernando Collor de Mello – whose presidency began in 1990 but was interrupted by impeachment proceedings in 1992. His plan for government was clearly intended to create a more open economy and increase international competition; it was also aligned with the neoliberal policies from the 1989 Washington Consensus – a set of policy prescriptions formulated by economists from financial institutions such as the IMF, World Bank and International Bank for Reconstruction and Development (IBRD).

During his inaugural speech to Congress on March 15, 1990, Collor outlined the bill that would eventually become the National Denationalization Program (NDP) instituted by Law 8031/1990. He highlighted that privatization was capable of increasing "administrative and productive efficiency as well as generating fresh investment, which would help increase the supply of basic goods at lower prices". Collor believed that denationalization would not be limited to just selling off companies, it should also offer the private sector concessions to run public utilities and carry out public works, subject to legal regulation.

This meant the NDP became something quite different from the privatization movements of previous administrations. It fundamentally redefined state intervention in the economy. Its main goals were to reduce public debt, rekindle business investment, modernize Brazil's industrial base and strengthen the capital markets. At the time, companies placed in the privatization program were responsible for basic industrial infrastructure, such as steel (Usiminas), petrochemicals and fertilizer manufacturing. Eighteen of Brazil's 68 state-owned companies were privatized during the Collor era.

Itamar Franco took over the presidency after President Collor was impeached and forced to stand down. During his administration, denationalization lost some of its impetus, but not its importance. There were two massive privatizations during his presidency: Companhia Siderúrgica Nacional (CSN) and Embraer, the latter an icon of Brazil's aeronautical industry and the world's fourth-largest company in that sector.

However, despite gaining a boost during Collor's administration and continuing during Itamar Franco's, privatization really took off during the two consecutive administrations of President Fernando Henrique Cardoso (1995-2002), who followed Itamar Franco. FHC worked intensely with Congress to privatize major state-owned enterprises in the telecoms (Telebrás), power (Eletropaulo and Light) and mining (Companhia Vale do Rio Doce) sectors, as well as a number of state-owned banks. The process also whipped up a lot of controversy. Between 1990 and 2004, federal and state governments generated revenues of US$106 billion[1] , however Brazil's borrowings continued to grow – Brazil's public debt, which was 30% of GDP in July 1994, jumped to 60% of GDP in July 2002[2] , when the privatization process reached its peak.

When President Luiz Inácio Lula da Silva took office (2003-2010), privatization started to change shape. Instead of selling off large companies, the government started selling concessions, particularly for federal highways and hydroelectric power stations (Jirau and Santo Antônio). During the PT administration (the Workers' Party, PT, is the party of former presidents Luiz

1 BNDES. 2015, in: https://web.bndes.gov.br/bib/jspui/bitstream/1408/6762/3/PND_2014_P.pdf.

2 IPEA, in: http://www.ipeadata.gov.br/ExibeSerie.aspx?serid=38388.

Inácio Lula da Silva and Dilma Rousseff), the process intended to become "more socially oriented" as it rewarded companies bidding for concessions that offered the lowest end-user tariffs. Lula's successor, Dilma Rousseff, continued the policy and extended concessions into other major sectors including ports, railways and airports (Guarulhos-SP, Galeão-RJ, Viracopos-SP, Brasília-DF and Confins-MG). That format ended up frustrating its objective, in many cases, since the premises assumed for the economic models revealed inconsistences over time. Right now, it is being thoroughly scrutinized and redesigned based upon more solid economic projections.

Petrobras may also illustrate the shift of perspective from FHC to PT (the corruption debate is not being considered here). Fernando Henrique Cardoso enacted the conspicuous "break" of Petrobras monopoly in the oil exploration business. Though some Petrobras' privileges had been preserved, from that time on, foreign companies were allowed to explore for new reserves in Brazilian territory, including its alluring extension, which was the continental submarine platform.

The following government, marked by a biased "statism", pushed the pendulum toward the opposite direction, mandating that, for any new exploration area licensed, Petrobras would have to keep a participation of at least 30%. On top of that, the federal government commanded Petrobras to acquire a minimum percentage of local machinery and equipment. Those two guidelines have been deeply criticized, since they have engendered extreme setbacks. First, the current debt burdening of the company and second, overprice and inefficiency at the company´s acquisition and building processes.

Performance

Overall, privatizations revenues generated between the Collor administration and Dilma's first presidency (1990–2014) brought in US$106.2 billion for both state and federal governments. Federal privatizations included those allowed under Law 9491, dated September 9, 1997, which created the NDP, and the General Telecommunications Act – Law 9472, dated July 16, 1997.

The most recent report from the Brazilian Development Bank, BNDES[3] provides an overview of Brazilian privatizations between 1990, when the NDP was created, and December 2014, including not only revenues from NDP program privatizations, but also those raised by Brazil's states from their own privatization programs and those from the sale of federal telecommunication companies.

Between 1990 and 2014, the NDP generated the equivalent of US$31.1 billion from company sales and disposals of a number of minority shareholdings. This sum, in addition to the value of debt

[3] https://web.bndes.gov.br/bib/jspui/bitstream/1408/6762/3/PND_2014_P.pdf.

transferred to the private sector, worth around US$9.2 billion, means that overall, the NDP generated something in the region of US$40.3 billion.

There is little recent literature evaluating the NDP. The research offering an overall assessment of the program dates back to the end of the 1990s. There are more recent studies that have attempted to understand certain specific aspects and repercussions of the NDP, such as the program's impact on the energy sector in Brazil's Northeast region. The results describe one significant outcome: privatization was good financially, i.e. it benefited shareholders. However, the same cannot be said from a technical standpoint (service quality), i.e., as far as consumers are concerned, privatization did not result in any significant improvements[4] .

A study carried out by researchers at the University of São Paulo looked at data from 102 privatized manufacturing companies and a control group of publicly listed companies, made up of 20 state-owned enterprises and 158 private sector companies. On one hand, the results indicate that efficiency rose at these companies after privatization. More specifically, an increase in profits and operational efficiency could be observed. Apparently, the fact that these companies could no longer count on financial support from the state had a significant impact on their financial structures, and researchers observed an increase in current liquidity and a reduction in long-term debt. On the other hand, the effects of privatization on investment, output levels, dividend payments and taxation are less clear[5] .

According to these academic studies, the effective outcome of the privatization programs implemented by Brazil's governments over the past 27 years is unclear, as there is no data showing any significant improvement in the services provided by these private companies nor the way the federal government allocates these assets in order to maximize net social benefit, rather than simply pay off debt.

Constant oversight is needed to ensure the services from privatized companies improve and to verify whether privatization and revenue goals are achieved and whether public capital is being properly reallocated. As a result, regulatory agencies were created with the mission of supervising the public services transferred into the private sector. The advent of these agencies was, on one hand, an attempt to protect regulatory activity from political party interference and, on the other, to avoid the type of conflict caused by inappropriate state interference, as majority shareholder, by giving the

4 Silvestre, Bruno dos Santos et al., 2010, "Privatization: Good or Bad? Lessons from the Electrical Energy Distribution Sector in Brazil's Northeast", Revista de Administração de Empresas – RAE/FGV, São Paulo, vol. 50, n. 1, pp. 94-111.

5 Anuatti-Neto, Francisco et al., 2005, "The Effects of Privatization on the Economic and Financial Performance of Privatized Companies", Rev. Bras. Econ., Rio de Janeiro, vol. 59, n. 2.

agencies sufficient legal autonomy. Today, we find that most of these agencies have either fallen back into the old political rut, or have been starved of the funding they need to operate effectively.

Good governance is critical to support regulators. The state not only needs to regulate, it must also comply with and enforce existing legislation and use privatization windfalls to make public investments in infrastructure, research, health, education and safety. Based on the debate with civil society, we should periodically reassess whether it is appropriate or necessary for the state to intervene in the production of goods and services and consistently question whether the initial reasons for creating a state-owned enterprise are still relevant and justify government involvement in a given sector.

Finally, Brazilian NDP progresses in fits and starts. This reveals two structural defects.

The first is that privatization takes on greater importance at times of macroeconomic adversity, based on the fragile narrative of necessary fiscal rebalancing. During privatization, the layman usually interprets this as the government selling the family silver to pay off a debt that attracts a very high, and therefore unfair, rate of interest. People are not convinced that the massive amount of state capital tied up in inefficient operations, or that might be substituted by private capital, could be used to fund public investments that would benefit the entire population.

Second is the partial and relative failure of Brazil's regulators. Their actions fall too short, which means that privatized services, that were spectacularly more efficient at the outset, are no longer appreciated by their users who then go on to incorrectly imagine that state-owned enterprises would be more responsive to their demands.

As the cycle begins again, some people start to revisit the weak argument that the government needs to sell assets to pay off its debts and rebalance the domestic budget. This is a rocky road, as it has ever been.