Brazilian Privatization: The Rocky Path from State Capitalism to Regulatory Capitalism

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Introduction

Building an institutional framework conducive to a more efficient allocation of resources -- capital, labour, knowledge, and managerial skills -- is a key pillar in the process of structural adjustment and reform currently underway in most OECD and non-OECD countries. Privatization is a necessary step in this direction, insofar as state ownership may interfere with the goal of macroeconomic stabilization, may distort competition both on product and, through the use of public funds for patronage, political markets, and may subtract public funds from much more needed tasks such as education and healthcare. Almost twenty years of international experience, however, have shown the difficulties inherent in designing and implementing coherent sell-off programs. Manifold goals imposed on the process of state divestiture -- such as fiscal adjustment, financial markets' development, regulatory reform -- can easily prove at cross-purpose, at the same time as the political opposition to privatizations makes it necessary to find strategies of appeasement that may water down the zeal of reformers. Moreover, in many emerging markets the huge capital inflows associated with privatizations may come to endanger macroeconomic stabilization.

The exhaustion of the state-intensive model of economic development makes it necessary to design a new "compact" to regulate the interactions between the market, the state, and the political realm. In view of the cross-countries resemblance of reasons for privatizing, actual implementation and results show a surprising degree of variation. In particular, governments may conceive of sell-offs as an ambitious "grand" strategy aimed at redesigning economic relations, as in the United Kingdom and Chile; or more simply as a way of distinguishing their policies from those of the previous administration (France); or as something that has to be done willy-nilly in light of a macroeconomic crisis (Italy and Argentina).[1] Therefore, despite the common rhetoric about introducing "economic democracy", differing patterns are clearly discernible when looking at the consequences of privatizations and the tools put in place to solve the problems posed by the separation of private ownership and control. In the United Kingdom and Chile, the role of arms' length financial markets and institutional investors has been strengthened, the protection of investor rights reinforced, and independent regulatory agencies responsible for market structure regulation have been created. The state has not faded away, as shown by the preservation of special voting rights ("golden shares") and by the political relevance of the regulatory game, but it has preferred to increase the predictability of its intervention. In most other countries, privatization has reinforced long-run characteristics of corporate governance, pivoted around a reduced number of large business groups -- often family-owned, despite some separation between ownership and control, and immune from the threat of take-over --, a subsidiary role of markets (for goods and services, as well as for corporate control), and a very slow fading away of government's interference.

Since the outset of the Real Plan in mid-1994, Brazil has made considerable progress in economic stabilization. Results on the inflation side have been particularly dramatic, bringing down the monthly rise of the consumer price index from almost 50 per cent to less than 0.5

[1] See Bishop *et al.* (1995) on the United Kingdom, Bitran and Sàez (1994) on Chile, Goldstein (1996) on France, and Goldstein and Nicoletti (1996) on Italy. A similar categorizing is presented by Feigenbaum and Henig (1994).

per cent (August 1997). Despite the concurrent trade opening, however, structural reforms, and the “roll back” of the state in particular, have so far been very incomplete (Lara 1997), contributing significantly to the emergence of deep obstacles in the pursuit of high and sustainable growth rates (Dornbusch 1997). Brazil’s late recognition of the need to start privatization reflects four main factors. First, the preference that Brazilian society in general, and elites in particular, have revealed for real growth, however flawed, over macroeconomic and price stability.[2] Second, and related, the pride that Brazilian society in general has traditionally taken of its SOEs, which have been seen as the only successful example of indigenous entrepreneurship, safeguarding the Brazilian means of production from foreign investors that would repatriate profits and ignore national concerns. Third, the lack of a serious policy discourse by the Right, which supported the increase of public intervention during the military regime and has had a hard time in following privatization proposals with the reduction of subsidies and other rents. Fourth, the absence of a reform compact by the Left, that has seen privatization as something imposed by the “Washington consensus” of the US Treasury and the IMF, rather than as an opportunity for equity and efficiency. Yet, from the early 1990s onward privatizations have progressively gained momentum, so much so that by 1997 the Brazilian divestiture program could be hailed as the largest worldwide.

This study aims at answering a number of questions emerging from the Brazilian privatization experience. To what extent have state sell-offs been influenced by the peculiarities of Brazil’s legal and institutional framework, as well as from the domestic political context? How are Brazilian authorities coping with the issues regarding ownership patterns and market structures? And, taking into account the key role that “state capitalism” has played in the country’s economic development over the past 50 years, what model of corporate organization is going to emerge from the sell-off process? The first sections describe the history and the role of the public enterprise sector in the economy of Brazil, using a variety of indicators and drawing from different interpretative sources. The second section sets out the policy, legal and operational framework in which privatizations were implemented, compares its main features with those prevailing in some other countries, and provides an updated account of state sell-offs. The following two sections analyze the consequences in terms of corporate governance and regulatory reform.

1. The public enterprise sector in Brazil

1.1 From the 1930s until the Brazilian miracle

The range of activities performed by the Brazilian government as an entrepreneur, and the historical circumstances of its development, do not differ from the norm in all post-war market economies (Table 1). The process of state intervention was uninterrupted through a number of

[2] Shiller (1996, Table C8, p. 19) documents that Brazilian respondents (through e-mail) to his survey on people’s perceptions about inflation are more likely to prefer a high inflation/low unemployment scenario (rather than the opposite) than Americans and Germans (who were interviewed orally). The sample is admittedly small, but in the case of Brazilian the preference for growth is possibly underestimated since “baby boomers”, who are over-represented among e-mail users, are more inflation-adverse in the United States and Germany than other cohorts.

regime changes, although the underlying reasons may have varied from Getulio Vargas' *Estado Novo* in the 1930/40s, through the "developmentalism" season of Juscelino Kubitscheck in the 1950s, and onto the military dictatorship since 1964. The state intervened in three broad areas of. First, public ownership has been dominant, when not exclusive, in the provision of public services, i.e. telecommunication, electricity, water and sanitation, railways and urban transport. In such cases, the justification has been the traditional one that economies of scale and scope, capital market imperfections, and informational asymmetries make public ownership preferable to regulation of a privately-owned natural monopoly.[3] Second, the state has owned exclusive rights for the exploitation of non-renewable natural resources such as petroleum and iron ore, where strategic reasons made private, most often foreign, ownership undesirable. Third, governments have chosen to intervene directly in some manufacturing industries where private entrepreneurship was not forthcoming: steel in the 1940s, petrochemicals in the 1960s, aeronautics and electronics in the 1970s. In all cases, the state did not aim at maintaining an autonomous intervention, but rather at nurturing a "triple alliance" (*tripé*) with multinational corporations and local private entrepreneurs (Evans 1979). Public intervention provided the inducements to business necessary to encourage it to invest in Brazil, using triangular decision-making bodies -- the most famous one being the GEIA in the car industry -- to coordinate and cajole, rather than command, economic actors.

Table 1. A synthetic view of SOEs's history in Brazil

Company	Sector	Year established	Remarks
CSN	Steel	1941	Created, under strong pressures from the military, to assure independent production of steel products
CVRD	Mining	1942	Created as an alternative to foreign control of the Itabira deposits
Petrobrás	Oil	1953	Successor to the National Petroleum Council, created in 1938; enjoys monopoly over the exploration and refining of petroleum
RFFSA	Railways	1957	Created by merging 18 railways, progressively taken over by the federal government since 1920s; São Paulo lines under state control; unified company (FEPASA) created in 1971
CRT	Telecoms	1962	ITT-owned operator in Rio Grande do Sul, nationalized by the local government
Eletrobrás	Electricity	1962	"Mixed-economy" holding company controlling generation and distribution companies, either established by local governments or nationalized (e.g., American and Foreign Power Co.)
Embratel	Telecoms	1965	Created to organize long-distance and international services; in 1974 was granted a general exclusive concession
Embraer	Aeronautics	1969	Founded by the air force
Telebrás	Telecoms	1972	Holding company controlling most regional operators
Siderbrás	Steel	1973	Holding company gradually taking control over all public steel mills; abolished in 1990

Analyses about Brazilian state-owned enterprises (SOEs) are mingled with the wider scholarly debate about the nature of the Brazilian state;[4] this, in turn, has been put in a broader context

[3] Since Brazil's generation profile is heavily weighted towards hydro sources, with a correspondingly low need of peaking power plants, private investment is particularly risky.
[4] See Abranches (1992), Adler (1987), Bresser Pereira (1997), Evans (1979 and 1995), Schneider (1991), Shapiro (1991), Sikkink (1991), and Trebat (1983).

in recent years by comparisons with the institutional underpinnings of economic growth in Southeast Asia. Evans (1995) characterizes Brazil as an intermediate state. Compared to Japan, Korea, or Taiwan, Brazil did not implement a wide-ranging agrarian reform, and failed to make the granting of state support -- entry barriers, licenses, credits, tax holidays -- conditional upon the fulfillment of indicators of market performance, such as export targets. Relative to "ideal-type" of the "developmental state", in Brazil government intervention has suffered from a number of flaws -- lack of meritocratic recruitment, modernization "by addition" rather than through a grand design of structural transformation, uncoordinated expansion. Modernization efforts were limited to some agencies (*pólos de modernidade* or *bolsões de eficiencia*, in the Brazilian jargon) and failed to trickle down, "none of them reaching the hard core of state's problems, associated to clientelism and political patronage" (Abranches 1992, p. 121). Thus, although Brazil managed to avoid the extreme of a predatory state like Zaire, "the fusion of traditional oligarchic power with the modern state apparatus distorts any possible joint project between the state and industrial capital. Projects of industrial transformation become additional opportunities for the traditional oligarchy, now encapsulated within the state, to pursue its own clientelistic agenda" (Evans 1995, p. 63).

The Brazilian model of state-led capitalism, *prima facie* common to many other countries including large industrialized ones such as France and Italy,[5] contributed in all likelihood to the very rapid expansion before the 1973 crisis, and accompanied the simultaneous development of a shared commitment to the idea of planning and modernization that slowly gained ground during the years of the *milagre*. But intervention, coupled with trade barriers, cumbersome entry and exit regulations, and a plethora of *ad hoc* incentives, also ploughed the seeds of inefficiencies and distortions that have stopped the catch-up process during the following decades. A number of studies touching on different issues pertaining to Brazilian SOEs allow the following generalizations:

- SOEs, except the railways company, were given considerable autonomy in pursuing long-term goals, and entry by competitive examination and a clear corporate identity allowed them to attract competent managers. As long as Brazil enjoyed macroeconomic stability, the holding company structure adopted in telecommunications, electricity, and petroleum allowed a good balances between the twin objectives of operational flexibility and financial accountability;
- nonetheless, the larger public enterprises came to represent a real counter-power within the state apparatus. Given the lack of appropriate mechanisms for monitoring their behavior, state-sector executives "developed a vested interest in protecting their firms from outside interference" (Trebat 1983, p. 236-7), often appearing equally interested in improving corporate performance as in building their own empire;
- since the early 1970s, the government implicitly legitimized this behavior on the part of public managers, passing from the targeting of some key sectors to indiscriminate, across-

[5] This similarity mirrors the diffusion of Keynesian ideas of economic management in the post-war period, but also the desire of foreign donors and lenders to by-pass the public administration, regarded as inefficient, and to concentrate scarce human resources in a limited number of relatively autonomous SOEs. The establishment of some Brazilian SOEs was indeed suggested in the 1950s by the Joint Brazil-United States Economic Development Commission. On Italy, see Barca (1997, pp. 21, 30).

the-board assistance. At the same time as public authorities provided increasing support, in the form of credit subsidies, to private firms, the "triple alliance" model chosen to deepen import-substitution from simple consumer goods to more sophisticated industries called SOEs to uphold private customers through the sale of intermediate products at below-market-prices;

- after 1975, an ill-conceived and contradictory strategy of subordinating corporate goals to the objective of macroeconomic stabilization -- through price and tariff controls, limits on financing on both domestic and international capital markets,[6] and the obligation of obtaining government (and, following the return of democracy in 1985, Congress) approval for investment plans -- progressively worsened the financial situation of SOEs, paradoxically making them a burden to the fiscal budget.

1.2. SOEs' evolution since the 1980s crisis

In terms of both scale (Table 2) and scope (Table 3), the Brazilian public enterprise sector does not rank particularly high among non-OECD countries, nor relative to EU countries such as France and Italy. Brazilian SOEs are heavily concentrated in capital-intensive sectors, as shown by their low weight in total employment relative to GDP. Of the largest non-financial firms in 1984, 16 were public enterprises -- the federal government owned twelve, and states four more. Nonetheless, when utilities and Petrobrás are excluded, only four of the 20 largest manufacturing firms were public-owned, although admittedly the biggest four (CVRD, Copene, Usiminas, and Petroquimica União).[7] Public-sector presence is also sizable in financial intermediation, but not as imposing as in other countries. While the 1934 Constitution envisaged the gradual nationalization of all banks, public credit institutions control 56 per cent of loans and 59 per cent of deposits, while accounting for 51 per cent of total assets and 43 per cent of equity.[8] Their credit operations and loan portfolio are heavily skewed towards SOEs (The World Bank 1994, p. 43), a factor which partly explains the steady deterioration of the ratio of loans in arrears and liquidation over total loans..

Table 2. Brazilian SOEs in comparative perspective: quantitative indicators

	Brazil		Industrial economies[a]		Developing economies[a]		Latin America[a]	
	1978-85	1986-91	1978-85	1986-91	1978-85	1986-91	1978-85	1986-91
Share of GDP	5.0	8.6	4.5[b]	6.0[c]	10.4	11.0	9.0	9.2
Share of non-agricultural GDP	5.5	9.5	4.7[b]	6.2[c]	12.6	13.1	9.9	10.1
Share of gross domestic inv't	26.3	15.2	8.9[b]	6.2[c]	26.9	20.5	24.1	15.6
Share of employment	1.2	n/a	n/a	n/a	4.9	4.8	4.3	4.0

Notes: (a) weighted average; (b) 1982; (c) 1988
Source: World Bank (1995), *Bureaucrats in Business*, Oxford University Press.

[6] SOEs were initially constrained in their ability to seek external financing, then encouraged to do so when authorities adopted the so-called monetary approach to the balance of payment, predicated on the assumption that a build up of foreign debt would have pushed domestic inflation and interest rates toward convergence with industrialized countries.
[7] *Conjuntura Econômica*, September 1985.
[8] End-1996 (*Brazilian banking sector outlook*, JPMorgan, 1 August 1997).

Table 3. Brazilian SOEs in comparative perspective: qualitative indicators, **circa** *1992*

Sector	Brazil	Argentina	Chile	France	Korea	Italy	Mexico	Spain
Air transport	❍	❍	❍	●	❍	●	❍	●
Comm. banking	◎	◎	❍	◎	❍	●	❍	◎
Electricity	●	●	◎	●	●	●	●	◎
Petroleum	●	◎	❍	◎	●	●	●	◎
Railways	●	●	●	●	●	●	●	●
Steel	●	❍	❍	●	●	●	❍	●
Telecoms	●	❍	❍	●	●	●	❍	●
Tobacco	❍	❍	❍	●	●	●	❍	●
TV broadcasting	❍	❍	❍	◎	◎	◎	❍	◎
Urban transport	❍	❍	❍	●	●	●	❍	●
Water supply	●	❍	❍	❍	●	●	●	●

Notes: ● indicates fully or predominantly public sector; ◎ indicates mixed sector; ❍ indicates fully or predominantly private sector

During the 1980s, a decade which was characterized by a steep decline in investment at the macroeconomic level, SOEs' contribution to fixed capital formation fell markedly. Parallel to this, macroeconomic instability deepened. After surpassing the 50 per cent mark in 1979 and the 100 per cent one in 1982, yearly CPI inflation consistently remained above 200 per cent (bar 1986) until 1993. Reasons and ill-fated cures are described and analyzed in a large number of scholarly contributions. Suffice here to observe that privatization plans were given, if any, a very minor role in the context of macroeconomic management. On the premises that inflation was basically inertial -- i.e. stemming solely from the indexation law and practice -- the March 1986 Cruzado Plan (as well as the Cruzadinho in July and Cruzado II in November) pivoted around incomes policy to freeze price and tariffs, prominently among them those of public utilities. This strategy not only failed dramatically in reducing price rises, but aggravated the crisis of SOEs, increasing capital transfers from the central government (which in 1987-88 amounted to 2 per cent of GDP), and therefore fiscal imbalances. The 1987 Bresser Plan, while also including an emergency price freeze, at least considered the prior need for public tariffs to be adjusted in order to rebalance relative prices; more importantly, it mentioned privatization as an element of the necessary fiscal redressing, a policy statement that was repeated in early 1989 in the Plan Verão, although it did not receive any practical implementation. At the end of the decade, net receipts from state divestiture, all through private placements, amounted to a paltry US$ 200 million (Cardoso 1992).[9]

2. Privatization in the 1990s

2.1. Framework

In spite of long-lasting signs of inefficiency, it was only in April 1990 that the Collor government launched the *Programa Nacional de Desestatização* (PND), a far-reaching plan

[9] The three largest SOEs sold during this period were Eletrosiderúrgica Brasileira, Aracruz Celulose, and Caraíbas Metais.

which has remained the main policy document throughout three different administrations. Objectives are clearly spelled out:

- to allow the state to modify the nature of its intervention, focusing its actions and resources in social policy;
- to reduce the public debt;
- to increase investment commitments in formerly state-owned companies;
- to stimulate competition, contributing to the qualitative improvement of goods and services; and, finally,
- to strengthen the stock market, through the *pulverização* of ownership.

The PND established a clear and transparent legal and regulatory framework for state retrenchment, which has been integrated through a series of successive measures, sometimes responding to new pressures emerging in the course of the privatization process itself (Table 4). The inherited institutional and legal form of state ownership, as well as the legal structures chosen for implementing the sell-off of public enterprises, represent key issues in terms of the speed and transparency of the privatization process. In this respect, the polar cases are represented by the extreme legalization characterizing the French experience in 1986-88 and since 1993 and the largely discretionary approach adopted by the United Kingdom. In the former case, in particular, constitutional impediments to privatization, concerning the range of public enterprises which can be privatized as well as the conditions of their sale, forced the French government to legislate a comprehensive (and legally enforceable) framework for state sell-offs, detailing the mechanisms of both *ex ante* and *ex post* monitoring, and a complete list of enterprises to be sold. This stands in stark contrast with British privatizations, which were decided case-by-case, were regulated by separate laws, and were not subject to any formal *ex ante* monitoring.

Brazil emerges as an intermediary example. Legal state monopolies existed in a number of sectors, making it necessary to introduce constitutional amendments to open them up to privatization and/or competition. Responsibilities have been tightly concentrated in a single agency, the BNDES, which depends from the government but is functionally independent. In most other countries, both in Europe and in developing economies, responsibilities are more evenly spread across different bodies,[10] but in Brazil the predictable opposition to privatization made it preferable to insulate technical decisions from political pressures. The BNDES is indeed a quintessential example of the *bolsões de eficiencia*, parts of the bureaucracy where reformists reinforced the merit system while continuing to use other parts of the state apparatus for political patronage (Sikkink, 1991, p. 176). Founded in 1952, following recommendations by the Brazil-United States Mixed Commission, to provide long-term finance, the BNDES has traditionally been the center of structuralism economics in Brazil, assisting the overall strategy of import-substitution industrialization by successively concentrating lending in railroad, electrical energy, steel, automobile, and information technology projects. Despite its pro-intervention imprinting, the BNDES was chosen for a

[10] See Goldstein and Nicoletti (1996, table 1, p. 432), for a comparative view of institutional arrangements in privatization.

number of reasons.[11] First, because it had accumulated an unsurpassed expertise. Second, because it started recognizing the opportunities which privatization opened to Brazil well before a consensus in this sense emerged in the rest of the elite (Velasco 1997a). Third, because BNDESPAR, its fully-owned investment bank, had been accumulating direct shareholdings in a number of important companies as a result of the conversion of non-performing loans.

[11] A similar *problematique* has emerged in other countries. In Chile, CORFO has been the government's agency devoted to privatizations, whereas Italy's IRI has often posed obstacles on the way of the government's plans to divest of the former's subsidiaries.

Table 4. Main privatization laws and decrees in Brazil

Law 8031/90	Stipulates that a foreign investor can acquire no more than 40 per cent of voting shares, unless explicitly authorized otherwise by Congress.
Decree 99463/90	Establish the Brazilian Privatization Program (PND); defines as subject to it all companies directly or indirectly controlled by the federal government, as well as private-sector companies which for whatever reason has been taken over by the federal government; excludes companies engaging in activities in the exclusive domain of the federal government; and institutes the Directive Committee (CD) to manage both public holdings in companies to be sold (kept in the special Brazilian Privatization Fund, FBD) and privatization operations
Decree 99464/90	Appoints the BNDES as the government's agent responsible for managing the FBD and sets the list of companies to be privatized at an early stage; successive inclusions are to be decided by the President of Brazil
Decree 915/93	Regulates self-generation in electric power
Decree 1309/93	Creates the national power transmission system (SINTREL)
Decree 1068/94	Extends the scope of the PND to include all minority participation hold by all public sector bodies
Decree 1204/94	Abolish any limit on foreign ownership of voting shares, unless stipulated otherwise by the government
Law 8884/94	Competition law, splitting responsibilities between the SDE (in the Ministry of Justice) for fact-finding investigations; the SEAE (in the Ministry of Finance) for the economic analysis; and the CADE (granted independence by the law) for taking decisions
Provisional measure 841/95	Replaces the CD with the National Privatization Council (CND), permanently composed by five ministers, as well as (on a case-by-case basis) by ministers with sector competences, and the president of the Central Bank when privatization in the financial service are discussed
Law 8987/95	Regulates the granting (through competitive bidding based on the price offered for a given tariff set by the state) of concessions for provision of public services; sets the basis for settling any dispute between public authorities and concession-holders through arbitration procedures
Law 9074/95	Regulates the activity of independent power producers
Constitutional revision 7/95	Modifies article 177, paragraph 1 of the Constitution, to allow the federal government to let private investors operate in the oil and gas industries
Constitutional revision 8/95	Modifies the Constitution to allow private investment in telecommunications, limiting foreign ownership to 49%
Decree 2003/96	Regulates power generation by self-producers and independent producers
Decree 2077/96	Simplifies procedures to be followed in the privatization of public services
Law 9295/96 (*lei minima*)	Institutes the Cellular Mobile Service (SMC), to be provided by concession-holders in competition with Telebrás, and opens to private investors the provision of value-added services
Law 9427/96	Sets up the National Electricity Agency (ANEEL) and indicates the main provisions for the discipline of concessions in electricity
Constitutional revision 13/96	Abolishes the state monopoly for reinsurance
Law 9457/97	Modifies the 1976 corporation and securities market laws, abolishing the need for a public offer when there is a control change in a listed company, limiting the withdrawal rights for dissenting shareholders, slightly expanding the prerogatives of the audit committee, and strengthening the duties of the Securities Commission (CVM)
Law 9472/97	Sets up the National Telecommunications Agency (ANTEL) and indicates the main provisions for the regulation of telecommunication services

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Table 5. Main privatizations in Brazil, 1991-1997

Date	Company	Sector	Price (m$)	Stake sold	Buyer(s)
Oct 91	Usiminas	Steel	1,941	100 %	Nippon Steel, CVRD, Previ
Apr 92	Petroflex	Petrochemicals	234	100 %	Suzano Feffer
May 92	Copesul	Petrochemicals	862	100 %	Odebrecht, Suzano Feffer, Petrobrás
Jul 92	Companhia Siderúrgica de Tubarão	Steel	347	100 %	Bozano Simonsen, Unibanco, CVRD
Aug 92	Fosfértil	Fertilizers	182	100 %	Consórcio Fertifós
Oct 92	Acesita	Steel	465	100 %	Previ, Sistel, Banco Safra
Apr 93	Companhia Siderúrgica Nacional-CSN	Steel	1,500	100 %	Vicunha, Bradesco, Bamerindus, Itaú, Docenave, employees
Jun 93	Ultrafértil	Fertilizers	206	100 %	Fosfértil
Aug 93	Companhia Siderúrgica Paulista-Cosipa	Steel	586	100 %	Uniminas
Sep 93	Açominas	Steel	599	100 %	Grupo Mendespar
Jan 94	PQU	Petrochemicals	288	100 %	Polibrasil, Oderbrecht
Dec 94	Embraer	Aeronautics	192	controlling 45 %	Bozano Simonsen, Wasserstein Perella, Sistel, Previ
Jul 95	Escelsa	Electricity distribution (ES)	387	85 %	Brazilian banks, social security foundations, employees
Aug 95	Copene	Petrochemicals	270	100 %	Norquisa
Sep 95	CPC	Petrochemicals	100	100 %	EPB, Mitsubishi
Oct 95	Salgema	Petrochemicals	139	100 %	EPB, Copene
Mar 96	RFFSA (Malha Oeste)	Railways	63	30-year concession	Bank of America, Chemicals Bank
May 96	Light	Electricity distribution (RJ)	2,357	70 %	Electricité de France, CSN (Electrobrás retains 29%), AES
Jun 96	250 km of highway	Road transport in São Paulo	1,845	20-year concession	Tratex
Jun 96	RFFSA (Malha Leste)	7,080 km railways	317	30-year concession	Banco Garantia, CRVD, Railtex International, CSN
Sep 96	RFFSA (Malha Sudeste)	1,674 km railways (SP, RJ, MG)	871	30-year concession	CVRD, various steel and construction companies, Bradesco
Nov 96	CERJ	Electricity distribution (RJ)	587	70 %	Enersis, Endesa, Electricidade de Portugal
Dec 96	RFFSA (Malha Sul)	6,586 km railways (PA, SC, RG)	209	30-year concession	Banco Garantia
Dec 96	CRT	Fixed-line telephony	656	35 %	Telefónica de España
Jan 97	Polibrasil	Petrochemicals	100	100 %	Montell, Suzano Feffer
May 97	Companhia Vale do Rio Doce-CVRD	Mining	3,135	45 %	CSN, NationsBank (employees' pension funds have 30 %)
Jul 97	Greater São Paulo Band B services	Cellular telephony	2,470	15-year concession	BellSouth, Banco Safra
Jul 97	Band B services	Cellular telephony (BA, SE)	232	15-year concession	Vicunha, Globo, Bradesco, Stet
Jul 97	Companhia Estadual de Gás and Riogás	Gas distribution (RJ)	576	n.a.	Gas Natural, Iberdrola

Jul 97	Copel	Electricity generation (PA)	500	10 %	international share issue
Jul 97	Banerj	Banking (RJ)	300	n.a.	Itaú
Jul 97	Companhia de Electricidade de Bahia	Electricity distribution (BA)	1,600	66 %	Iberdrola, Banco do Brasil, Previ
Sep 97	Cachoeira Dourada	Electricity generation (GO)	714	100 %	Endesa (Chile)
Sep 97	Terminal de Contêineres (Tecon 1)	Seaport	250		Opportunity, Sistel, Previ
Oct 97	CEEE (Norte-Nordeste)	Electricity distribution (RG)	1,635	91 %	VBC (Votorantim, Bradesco, Camargo Corrêa), Previ
Oct 97	CEEE (Centro-Oeste)	Electricity distribution (RG)	1,510	91 %	AES
Nov 97	Companhia Paulista Forza e Luz	Electricity distribution (SP)	3,000	67 %	VBC, Previ, company's pension fund
Nov 97	Enersul	Electricity distribution (MS)	568	55 %	Escelsa

Fernando Collor Administration (1991-92)	3,497
Itamar Franco Administration (1992-94)	5,099
Fernando Henrique Cardoso Administration (since 1994)	>10,000

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2.2. Results

Choosing among different techniques for selling SOEs -- (fixed-price or Dutch auction) domestic public offers, international public offers, private placements, management buy-outs, employee ownership plans -- and combinations of them, depends on

- the nature of the firm for sale;
- the arguments included in the government's objective function;
- the political situation; and
- the presence of, and potential interest shown by, different class of investors (on this point, see sections 3.1. below).

In 1991-92, managing the sell-offs proved more difficult than expected, reflecting the shaky financial situation in some SOEs earmarked for immediate sale and the presence of minority shareholders (often entrusted with a priority right to acquire other shareholders' stocks). Moreover, if the Fernando Collor presidency initially met one of the pre-conditions for implementing structural reforms -- a head of the executive apparently committed to this goal -- it fell very short of satisfying many others, such as an efficient and high-quality economic team, the ability to build a consensus for reforms within society, and, as allegations of corruption started tarnishing the president only a few months into office, statesmanship. Despite such problems, however, total receipts realized during Collor's presidency, slightly less than US$ 4 billion, mainly in the petrochemical and steel sectors, far outweighed those obtained in the previous decade. The new administration, headed by Collor's vice-president Itamar Franco, initially froze the PND,[12] but was then obliged to resume the program in the face of mounting fiscal concerns, finally leading to the almost complete exit of the state from manufacturing (Table 5). The sequencing of privatizations has two main facets: what should be privatized first and whether ailing firms should be restructured before their sale. During the Collor and Franco periods, privatizations were confined to manufacturing, where the simultaneous trade opening of the Brazilian economy was deemed sufficient to assure competition. Prior restructuring involved changes in management, labour-shedding, and consolidation of the balance sheet, not without unions' resistance as in the 32-day strike at CSN in 1990.[13] Enterprises were sold through public auctions at the Rio Stock Exchange given a minimum offer price, payments being mainly through discounted public federal debt instruments (*moedas pobres*).

During the *era do Real*, moving on to public utilities and banks has been a key element of economic policy. Fernando Henrique Cardoso, previously Foreign and Finance Minister under Franco, had expressed his desire to broaden the scope of privatization well before winning the mandate.[14] While keeping the PND masterplan, some important changes have been made. The minimum ratio of cash payments has been raised to 40 per cent, the remainder being in unpaid obligations of the Federal authorities to the unemployed and the housing funds for employees.

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[12] In resigning in March 1993, the president of the BNDES accused the government of "egregious incompetence" ("Brésil: déboires politiques", *Le Monde*, 13 July 1993).
[13] "Brésil: Volta-Redonda trahie par l'acier", *Le Monde*, 22 December 1992.
[14] "Un entretien avec le ministre brésilien de l'économie", *Le Monde*, 5 October 1993.

The sale procedure remained the same until the privatization of Cerj, owned by the Rio de Janeiro state government, for which bidders presented closed-envelope proposals. Parallel constitutional revisions have been approved, not without resistance, to liberalize ownership and access in the telecommunications, electricity, and petroleum industries (on this point, see sections 3.2. below). Privatizations also reached the state level, as governments entered into agreements with the Finance ministry to restructure decentralized debt on condition that they increase the primary surplus and sell public enterprises.[15]

A milestone was passed in May 1997 when the "strategic block" of CVRD, the world's largest iron ore producer and exporter as well as the biggest gold producer in Latin America and one of the biggest aluminum and steel companies in Brazil, was sold. Political tensions ran high ahead of the sale, the oppositions by many politicians -- mainly in states where the company accounts for a sizable chunk of employment -- being coupled with the emotive content of selling 500 years of iron ore reserves.[16] The government set the minimum price as the average share price over the three previous months; put a 45 per cent ceiling on individual shareholdings; required the controlling consortium to include at least three firms, and not to sell shares for two years; and appeased political opposition both by evenly splitting receipts between the Fundo de Amortização da Dívida Pública (FAD) and the newly-created Fundo de Restructuração Econômica (FRE) to finance infrastructure projects and maintaining a five-year "golden share" to veto changes of ownership. Despite a heated legal controversy -- no less than 135 lawsuits were promoted against the BNDES, and the auction was delayed by 48 hours[17] -- CVRD was bought by a consortium led by CSN.

2.3. An early appraisal

A very preliminary assessment must first acknowledge that in the early 1990s authorities gave highest priority to the objective of quickly starting the sell-off drive, in order to build up their credibility *vis-à-vis* the international financial community. In other countries, for example Argentina, this urge has come to the detriment of transparency, but the Brazilian privatization program has not been tarnished by any suspicion of irregularities and corruption. It is also positive that so far Brazilian authorities have decided not to keep special veto powers through the issue of a golden share, although it is also fair to add that issuing such shares is much easier for governments which do not face a fiscal crisis making fast sell-offs imperative.[18]

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[15] The BNDES established a revolving fund to provide advances on privatization proceeds to six states. It held for example a 33 per cent stake in CEMIG as collateral for a loan advanced in 1996 in exchange for a commitment by the Minas Gerais state government to sell off a portion of the utility. Eletropaulo's shares owned by the state of São Paulo were also pledged as part of the restructuring of the state's debt against the Treasury. Shares of various local public enterprises, such as Cesp, Cemig, and Telesp, are traded, either in Brazil or as American depository receipts and equity-linked Eurobonds.

[16] CVRD's statutes stipulate the company should transfer up to 8 per cent of net profits into health, environment, and infrastructure project in areas where it operates. Former presidents Sarney and Franco also opposed the sale, arguing that CVRD was a well-run SOE, supporting Brazil's international trade policy ("Oposição a favor", *Veja*, 27 November 1996).

[17] "Folia judicial", *Veja*, 7 May 1997. The first privatization free of lawsuits was that of Enersul in November 1997 ("Escelsa paga 83,8% de ágio e fica com a Enersul", *O Globo*, 20 November 1997).

[18] The state of São Paulo intends to keep a golden share in Eletropaulo to guarantee, for example, investment in rural areas ("'Potential Energy'", *Infrastructure Finance*, June 1996).

Another positive feature regards the use of proceeds. Sales of public assets are financial transactions which should be recorded "below the line" in government accounts and may contribute to fiscal consolidation only by reducing public debt. Although, under certain conditions, sales of public assets should leave public net worth unaffected, there are good reasons to believe that, in Brazil, privatizations may contribute to fiscal consolidation through their positive effects on net debt service and primary balances. In 1988-94, the return-on-assets ratio has been considerably *negative* for the whole SOEs sector, and even for the sub-sample of the best-managed SOEs (CVRD, Telebrás, Eletrobrás, and Petrobrás) the return has been (and is likely to remain in the future) well below the cost of servicing public debt (Giambiagi and Pinheiro 1996). It is therefore profitable for the state to sell its assets for redeeming debt; debt service may decline as interest rates are lowered, on account of credibility gains and improvements in the size and efficiency of financial markets; and efficiency gains linked to improved performance of privatized firms may lead to higher GDP growth, which would permanently increase government revenues. Therefore, even after discounting costs incurred during sell-offs, the positive effects of privatizations on public net worth can be expected to outweigh the negative influences. Brazil correctly treats proceeds as deficit-financing, not deficit reduction. In any case, even if the totality of public enterprises were to be sold, with all privatization proceeds used to redeem public debt, the impact would be limited, since it was estimated, that at the prevailing real interest rates, sell-off receipts should amount to 3 per cent of GDP in order to stabilize the (domestic) debt-GDP ratio at 34 per cent.[19]

In terms of performance, Pinheiro (1996) presents evidence supporting the hypothesis that, for the sample of manufacturing firms sold in the 1980s and early 1990s, the change of ownership had a positive impact on a number of indicators such as production, labor productivity, profitability, and investment. This is consistent with the hypothesis that, in fragmented competitive markets, where competitive pressures hold, private companies outperform SOEs.

3. Privatization policies in perspective: the unsettled issues

While the track-record of the Brazilian privatization strategy is still relatively short, it is possible to discern some early successes. Yet essential questions remain unanswered. Should state divestitures be aimed at modifying a corporate governance system largely based on majority control, little monitoring from the stock market and institutional investors, and disregard for the rights of minority shareholders? Is transfer of ownership from public to private hands the ultimate goal, or should privatizations be seen as an opportunity to introduce competition in sheltered and monopolistic markets?

3.1. Ownership structure and corporate governance

The PND, as similar privatization policy plans in the rest of the world, explicitly lists the creation of people's capitalism among its five main goals. Nonetheless, the limited size of

[19] CNI (1997), *Fax econômico*, 18 August.

capital markets -- attributable to financial repression and instability, *in primis* consistently high inflation eroding the value of savings -- augurs badly for the realization of large-scale placements (Table 6). Reflecting the conflict between pro-interventionist and liberal positions in policy-making circles, there have been shifts in the model of industry financing sought (Armijo 1993). After 1964, as the pendulum shifted to the free-marketeers' end, a number of reforms were introduced to stimulate the development of capital markets, limiting cross-ownership between bank and commerce, granting tax benefits for investors in shares, and encouraging the formation of multi-purpose financial conglomerates. The financial costs of such measures has not been trivial, subsidizing to the upper class, until very recently the only one investing in shares. At the same time, liberalization was very selective, as private domestic banks were given a *de facto* market reserve by the closure of retail banking to new foreign entrants -- the existing ones being forbidden from opening new branches --, effectively bestowing on them the rents associated to the intermediation of subsidized loans. An equally important obstacle to the development of a shareholder culture has been the content, and application, of corporate law, which let virtually unpunished "many notorious cases of gross managerial irresponsibility or outright fraud by high-flying financiers" (Armijo 1993, p. 276). The action of the CVM, the stock market watchdog, has failed to do much in improving investor protection and increasing investors' confidence in the market. Given the country's high-inflation environment, the quality of published balance sheets is also regarded as of lower standard than the international norms.[20] Forms of contractual savings are also very weak, since the pay-as-you-go pension system is public-managed, and only covers the formal sector of the economy. Finally, changes of control do not usually happen on the stock market, since listed companies can issue non-voting, preferred shares for up to two thirds of capital, with no obligation to list voting stock. Block trade are the most common type of ownership transfer and small shareholders cannot expect to derive a short-term financial benefit from the market for corporate control.[21]

Table 6. Comparative stock market statistics

	Brazil[a]	United States[b]	Italy	Argentina	Chile
Capitalization (US$ bn)[c]	147.6	5,654.8	209.5	37.8	72.9
as a percentage of GDP	*21.5*	*81.3*	*19.3*	*13.4*	*108.4*
Number of listed companies[c]	544	2,242	254	149	282
Trading volume (US$ bn)[c]	57.0	3,082.9	87.1	31.9	11.4
as a percentage of GDP	*8.3*	*44.4*	*8.0*	*11.4*	*16.9*
as a percentage of capitalization	*38.6*	*54.5*	*41.6*	*84.5*	*15.6*

Notes: (a) São Paulo; (b) New York; (c) domestic companies' shares
Sources: Fédération Internationale des Bourses de Valeurs, *Statistics 1996* and IMF

[20] "Brazil groups create results jungle", *Financial Times*, 2/3 May 1996. Lacking strict norms, it is not obvious whether the incentive for companies is to underreport profits, as to elude tax obligations, or to exaggerate them, in order to attract external investors.
[21] The preferred dividend has priority in the allocation of adjusted net income, and after the payment, an equal amount is allocated to common shareholders. SOEs have traditionally issued large amounts of non-voting stocks, Petrobrás and the two utilities' holdings accounting for 74.3 of total stock exchange trading in July 1997 (BOVESPA, *Relatório mensal*).

The key feature of emerging countries' industrial organization, beside the role played by SOEs, is the importance of diversified business groups, "multicompany firm[s] which transact in different markets but [do] so under common entrepreneurial and financial control" (Leff 1978, p. 663). Among other tasks, groups substitute for lacking or weak arms' length capital markets by allowing the entrepreneur to draw financial resources through diversification into banking and other forms of savings management. In the process of corporate growth, however, groups typically dilute ownership, without surrendering control, by selling minority stakes in operating subsidiaries, and this contributes, at least in quantitative terms, to the growth of stock exchanges, as shown by Singh and Hamid (1992).[22] In Brazil, big domestic business, while important, have played a different and less important role, in terms of share of GDP, than in comparable countries such as India, Korea, and Mexico (Singh 1995, table B.0, p. 45).[23] Reasons have included the above-mentioned limitations on banking-commerce links, the origins of many private banks in financing agricultural exports, and the relatively earlier arrival of foreign companies on the Brazilian market. Moreover, as synthetically shown in Table 7, Brazilian groups have ventured into a lower number of lines of business than, for example, Korea's Samsung or India's Tata, and are weakly diversified into finance. Finally, Singh (1995), in a sample of listed companies in 10 developing countries, found that Brazilian ones tend to rely relatively less on equity finance and show lower gearing ratios.

For many Brazilian family-owned companies, often founded by European immigrants during the rapid post-war industrialization, the traditional troubles of inter-generational transfer coincided with the opening of the economy and the steep increase in the number of mergers and acquisitions, from 58 in 1992 to 328 in 1996 (CADE 1997, table 10, p. 27). Three directions of corporate strategy have emerged. In sectors characterized by global oligopolistic market structures, family-owned concerns too small to play a global role and face foreign competition have been taken over by foreign suppliers or domestic financial investors.[24] Companies such as Hering, Sadia, and Villares have reformed the shareholder structure, introducing clear rules for the separation of shareholder and management responsibilities, attracting external managers while keeping family members in the top executive positions, but have also decided to stay focused on their core business. Finally, other groups have participated actively in privatization, some on the steps of a long-term reliance on public procurements, such as Votorantim, Camargo Correia, and Oderbrecht, some as a means to diversify and minimize their exposure in more traditional areas, such as textiles (Vicunha) and paper (Suzano).

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[22] While this phenomenon is most common in developing countries, it is also found in Italy among large OECD countries. The result, however, has been to hinder the development of capital markets, since it is often associated to the lack of transparency in intra-group financial operations (Barca 1995).
[23] There was no private Brazilian presence in the 1995 ranking of the 500 world's largest enterprises, whereas there were six Korean private groups and one each from Mexico and Turkey (*Fortune*, 7 August 1995).
[24] In autoparts, for instance, Metal Leve, Cofap, and Freios Varga, family-owned companies ranking among Latin American leading industrial firms, have been taken over by foreign firms; domestic financial investors have taken control of Brahma, the world's sixth largest brewery, and Perdigão, a poultry firm; Philip Morris has bought Lacta.

Table 7. The largest business groups in Brazil

Group (year established)	Main sector of activity	Control (% of voting shares)	Listing (role of minority shareholders)	Presence in:	
				financial services	privatizations
Abril	Media	Civita family	no	no	no
Andrade Gutierrez	Construction	Andrade Gutierrez family	no	no	
Aracruz	Paper & pulp	Lorentzen (28), fin. partners	yes (58% non-voting shares)	no	no
Belgo Mineira	Steel	Arbed (18)	yes (pension funds own 32%)	no	no
Brahma (1888)	Food	Banco Garantia	yes	no	no
Camargo Correa (1938)	Construction	Camargo Correa family	no	no	yes
Gerdau (1901)	Steel	Johannpeter family (70%)	yes (86,000 shareholders)	no	yes
Hering (1880)	Textiles		no	no	no
Itamaratí	Construction, agribusiness	Olacyr de Moraes[a]	no	yes	yes
Itaúsa	Banking	Vilella and Setubal families	yes (Banco Itaú)	yes	yes
Klabin (1899)	Paper and pulp	Klabin and M. Aranha families	no	no[b]	no
Odebrecht (1945)	Construction, petrochemical	Odebrecht family	no	no	yes
Perdigão (1935)	Food	pension funds	no	no	no
Sadia (1944)	Food	Fontana family	yes	no	no
Suzano (1923)	Paper & pulp	Feffer family	yes	no	yes
Vicunha	Textiles	Steinbruch family	no	yes	yes
Villares	Steel	..	yes	no	no
Votorantim (1918)	Cement, aluminium, paper & pulp	de Moraes family	no (issued first Euro bonds in June 1997)	yes	yes
Weg (1961)	Mechanics	founders	..	no	no

Note: (a) creditors led by Bozano, Simonsen took over control in 1996; (b) Monteiro Aranha took over Banco Boavista in 1997 in partnership with Portugal's fourth largest bank

Privatizations are giving rise to a hybrid model of corporate structure, founded on coalitions of different investors -- domestic groups, public and private banks, and semi-public pension funds -- none of which can be said to exercise full control of the firm.[25] This features marks a difference relative to what has been the experience of Argentina and Mexico.[26] There, control was most often transferred to national private groups -- usually nurtured by public demand and strong in both industry and finance -- associated with foreign investors providing technical and managerial skills. In this sense privatization is seen as "business re-engineering guided by the state, whose strategy was aimed at strengthening the big national private groups as actors in

[25] Ownership of enterprises privatized between October 1991 and May 1997 was split among non-financial enterprises (39 per cent), financial enterprises (20), foreign investors (18), pension funds (13), and households (10) ("A agenda da privatização: 1997/2000", *Citicorp Economic Update*, 16 June 1997).

[26] See Bisang (1994) on Argentina and Garrido (1994) on Mexico.

the new economic model" (Garrido 1994, p. 167). This is not to say, however, that Argentine and Mexican governments used heavy-handed intervention. On the contrary, in both countries another distinguishing feature has been the low priority given to governance issues, testified by the relative delay in introducing mechanisms to police market power.[27]

The Brazilian strategy has responded to both political and economic factors. Politically, the larger the number of actors acquiring an interest in privatizations, the stronger the coalition that backs the government when opposition from other groups, such as workers and suppliers, emerge. The coalition model of control allowed to associate employees as investors, usually with a seat on the board, and to appease nationalistic fringes through the participation of public-sector banks, foundations, and pension funds (Velasco Jr. 1997a). The latter, in particular, invested over 1,400 US$ million between 1991 and 1995 (almost 60 per cent of which went to the steel industry), accounting for 16.8 per cent of overall privatization receipts.[28] Finally, in the early phase when inflation control was far from assured, authorities shied from the temptation of practicing "corporate re-engineering" as the risks of picking investors (or, more correctly, of creating losers) outweighed the possible benefits. Economically, this strategy responded to the dearth of the domestic capital market and to the limited initial interest shown both by existing business groups, notably in steel, and by foreign investors, notably in petrochemicals.[29]

As the sell-off drive gains momentum, however, this "minimalist" strategy may result inappropriate. The role of some public institutions in the post-privatization era may raise some doubts, and the soundness of the banking system not high enough to take light-heartedly the rise of finance-industry links. Foundations, i.e. semi-public non-profit service organizations, and the pension funds of the largest SOEs (Table 8) are not shielded from political pressures. The president of Previ, for example, is appointed by the president of Banco do Brasil, himself one of the key political appointments decided by the government. At the present stage the risk is that political pressures may push SOEs' pension funds to acquire excessive power, although it must be borne in mind that in 1993 president Franco, a long-time opponent of privatization, decided to disqualify them from taking part. Therefore, while the presence of semi-public pension funds in the winning consortium may reassure those private (and sometime foreign) groups to which they are allied, it may be seen with far greater suspicions by foreign institutional investors which keep an arms' length relationship. The government responded to these concerns by limiting to 25 per cent the total amount of consortia bidding in privatization that can be owned by pension funds.

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[27] The general point is made by Galal *et al.* (1994, p. 588): "sell only when the necessary accompanying policies are in place to make the divestiture a success". On the failure to follow this advice in Argentina, see Spiller (1993).
[28] ABRAPP (Brazilian pension funds' association) data (http://www.abrapp.org.br/mbra1new.htm).
[29] It was only in March 1996 that a foreign-led bid gained a privatization, the railways' Malha Oeste linking Bauru and Curumbá.

Table 8. The largest pension funds in Brazil

Institution	Company	Assets ($bn)	Participants	Retirees	Main participation in privatization
Previ	Banco do Brasil	18.723	87,165	40,143	Embraer, Escelsa, CSN, Usiminas, CPFL
Funcef	CEF	5.695	53,877	9,915	
Petros	Petrobrás	4.224	49,287	34,396	Acesita
Sistel	Telebrás	3.475	76,159	8,209	Acesita, Embraer
Centrus	central bank	3.375	5,582	2,284	

Figures are for December 1996

The involvement of credit institutions is also questionable. Brazilian banks prospered during hyperinflation, earning very high profits just by holding customers' money in low-interest cheque accounts and lending to the government at very high short-term rates. In this context, banks became very efficient in some areas such as cash management,[30] but they did not have any incentive to acquire skills to monitor loans and equity stakes in non-financial enterprises. The return to relative price stability hit them hard, and in the aftermath of the Mexico's crisis a number of institutions recorded very large bad-loans ratio and required public financial assistance, especially some public banks that had to be bailed-out. The Proer program, launched in late 1995, empowers the Central Bank to intervene in troubled private banks and to provide subsidized finance for their reorganization through acquisition, merger, or divestiture. The process of consolidation to create critical mass, slowed by the fact that many banks are family-owned, has advanced, but not to the point of taking light-heartedly a their larger involvement in privatization. First, banking privatization, especially that of those owned by state governments such as Banespa, Banerj, and Bemge, lags well behind schedule. The strategy increasingly adopted by state governments of cleaning their balance sheets by swapping debt due by states with shares in state-owned utilities may not reassure the latter' private investors. Second, governance problems abound even in private banks. Even if a provisional measure adopted in 1996 enhanced the responsibilities and role of external auditors, a key provision of Proer has been the revocation of the right of minority shareholders who object to a merger or sale to cash in their shares at the value stated in the most recent company accounts. Third, the record of banking participation in industry is rather dismal. Bamerindus, the bank that most consistently sought to acquire an industrial portfolio, ran in serious liquidity troubles and was taken over by a foreign bank (HSBC).

Selling state assets without guaranteeing efficient separation of ownership and management may also prove insufficient. The development of the equity market remains a policy priority, for the short-term need to find buyers for US$ 80 bn projected receipts[31] no less than for the long-term efficiency gains brought about by deep capital markets (Levine 1997).[32] New recent

[30] On the efficiency of Brazil's payment system, see Listfield and Montes-Negret (1996).
[31] "Brazil Monitor: The Privatization Schedule", *Citicorp Securities*, 2 July 1997. The first large-scale privatization on the stock exchange will be the secondary offer of the remaining 31 per cent state's stake in CVRD, initially expected for November 1997 and later postponed to early 1998.
[32] I interpret deepness as referring to qualitative and institutional development, in a broad sense, as opposed to sheer quantitative growth in stock market capitalization and turnover, whose positive impact on economic growth is not clear-cut (Singh, 1997).

measures aimed at stimulating the purchase of shares include a BNDES program to offer credit for the purchases of shares during privatizations, IPOs, and capital increases; the possibility for workers to participate in privatization by using savings accumulated in the FGTS (Fundos de Garantia do Tempo de Serviço) -- a fund where employees compulsorily deposit part of their salary to cover against unemployment risk -- to buy shares in *ad hoc* mutual funds (Fundo Mútuo de Privatização);[33] and the establishment of complementary individual pension funds (Fundo de Aposentadoria Programada Individual). Corporate law was also modified. The elimination of the obligation of tendering for all shares when the control stake in a listed company changes hands was needed in order to speed up the privatization plan. Other recent events, however, cast some doubts about the degree of protection that minority investors receive, including in some SOEs.[34] This shows that, in the trade-off between assuring the stability of control and protecting the rights of small shareholders, the balance remain heavily biased toward the former.

3.2. Ownership transfer and changes in market structure

The other main long-term goal associated to privatization is the increase of competition and therefore efficiency. Brazilian policy-makers clearly drove home the lessons from a number of foreign experiences. An oft-cited World bank study, for example, observes that “it is an essential truth that trading a public monopolist for its unregulated private equivalent is not guaranteed to enhance either the enterprise’s efficiency or the government’s chances of being kept in office by satisfied consumers” (Galal *et al.* 1994, p. 579). Discussing the conditions for establishing a “regulatory compact” requires a normative analysis -- what is the content of norms and regulations in imperfectly competitive markets -- as well as a institutional explication -- under which conditions future public regulation can be made more effective than direct state intervention in the past, given some political constrains.

A combination of ownership change, liberalization and better regulatory design holds the promise of large efficiency gains, and the privatization drive provides a historical opportunity for injecting greater competition in sectors traditionally characterized by a high degree of protection and the exercise of market power. Britain and Chile have been pioneers of reform and their experience shows that in order to reduce the regulatory burden *a*) restructuring has to occur before privatization, *b*) the nature of regulatory implementation and the span of intervention must be specified in advance in order to maximize certainty, *c*) decision criteria must be consistent across sectors and time in order to minimize the risk of regulatory arbitrage, and *d*) a clear arbitration system must be in place to solve disputes between utilities and agencies. Moreover, law-makers’ task is further complicated by the presence of important distributional issues -- in terms of both the price structure and the definition of the core of

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[33] As in other countries where such funds are used for divestitures, Brazilian trade unions have expressed some concerns, since the FGTS capital is in theory ear-market for social housing and other infrastructure projects (“Centrais divergem sobre uso do FGTS”, *Folha do S. Paulo*, 8 May 1997.

[34] Two recent cases involving Telebrás come to mind. Some consumers which had bought shares as a condition for receiving new lines were told that they were going to receive a cash payment below the par value; Telerj refused to convert equity warrants issued in 1991 on the grounds that it had been a mistake in first place to issue them.

universal services -- that have to be taken into account, struggling to strike a delicate balance with the need of introducing efficiency incentives.

In Brazil, exclusive concessions to public utilities were included in the Constitution, making market opening and privatization impossible until very recently. Industry-level laws were clearly outdated, having been issued in as late as 1934 for electricity and 1962 for telecoms. There are some important differences between telecommunications and electricity.[35] In both cases, the main corporate actors have been listed holding companies where the federal government owns the majority of voting stocks (50.04 per cent in Telebrás, but only 22 per cent of total capital, and 54 per cent in Eletrobrás), monitored by regulatory departments within the relevant ministries. However, while Telebrás controls the trunk-call operator (Embratel) and all the regional operators (except CRT in Rio Grande do Sul and three other very small companies),[36] in electricity Eletrobrás only accounts for roughly 50 per cent of total generation (through its subsidiaries Furnas, Chesf, Eletronorte, and Eletrosul, and the Brazilian stake in the Itaipú hydroelectric complex) and a fifth of distribution (Light in Rio de Janeiro). The remaining needs are assured by state concessionaires in both generation (36 per cent) and distribution (almost 80 per cent), and Itaipú imports from Paraguay. The ownership web is made even more complicated by equity links between Eletrobrás and the states in some distributors, such as Eletropaulo where Eletrobrás-owned Light has a 48 per cent stake with the São Paulo government owning the remaining shares.[37]

This regime, by giving federal holdings planning and policy execution responsibilities, clearly blurred the relationship between the regulator and the regulated, allowing a high degree of discretion in the exercise of monopoly power. Moreover, competencies were split among several ministries, local authorities, public companies, and national committees, except for the setting of a number of tariffs, which has been the responsibility of a single government committee, the CIP (*Conselho Interministerial de Preços*). The practice of hiring the bureaucracy from SOEs also did little to foster the development of independent and autonomous capacities within the regulatory bodies. Tariff decisions were often been subordinated to macroeconomic or social policy objectives, such as inflation control or equity considerations. None of these objectives was achieved, but long-run inefficiencies have been inserted.

In telecommunications, Brazil lags well behind the rest of Latin America in terms of access lines in service, digitalization, lines per employee, and quality of service (Table 9). The overall system favors the middle class relative to both business users and the lower class: subscribers are heavily concentrated in urban areas, the backlog for obtaining a new line is very long -- so

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[35] The following is partly based on Alves de Sousa and Moreira (1995), Birchal and Barbosa (1996), Klingelhoefer de Sá (1995), Ministério das Comunicações (1997), Rodriguez Pardina and Estache (1996), “Brazilian Telcos”, *UBS Securities Equity Research*, 18 June 1996, and “Eletropaulo”, *ibidem*, 26 June 1997.

[36] The government owns 22 per cent of total shares in Telebrás (51 per cent of common shares and 3.5 per cent of preferred shares), six subsidiaries of which are in turn listed (Telebrás owns 77 per cent of Telesp’s total shares and 82 per cent of Telerj’s).

[37] Light was split up into two different companies in 1995: LightRio was then sold off in 1996, whereas LightPar now holds the original utility’s stake in Eletropaulo and the latter’s US$ 1.24 bn debt towards Light.

that a black secondary market has developed --, and sizable cross-subsidization continues despite some rate rebalancing since the early 1990s.[38] In electricity, the single nation-wide uniform tariff in place between 1977 and 1993 for all companies, and the system of compensation (CRC) to equalize price and cost differentials, amounted in practice to a rate-of-return regulation, discouraging managers from seeking higher efficiency, since the benefits would have to be passed on to other utilities. Short of retained earnings or government-provided finance, investments have failed to meet the new needs of the country and to assure maintenance of existing assets: energy losses passed from 13 per cent in 1990 to more than 16 per cent in 1996, and black-outs are relatively frequent.[39] The amount of investment needed to complete the interconnection between the Northern and the Southern transmission lines and add new generation capacity (partly gas-fueled following the finishing of a gas pipeline from Bolivia) is huge, possibly exceeding US$ 85 bn over the 1998-2000 period.[40]

Table 9. Telecommunications in Latin America

	Telebrás	Telefónica Arg	Telecom Arg	CTC (Chile)	Telmex
Fixed lines per 100 pop.	8.1	10.0	8.3	15.9	9.8
Cellular subscribers (‘000)	2,085	134	165	175	657
Lines per employee	141	256	232	229	180
Digitalization ratio (per cent)	57	78	96	100	90
Market capitalization (US$ bn)	30.4	7.7	5.0	6.3	17.8
Free float (per cent)	78	30	30	41	68
Weight in local stock exchange	50.4	5.0	4.2	11.1	20.1

Source: “Telecoms in Latin America”, *UBS Securities Equity Research*, February 1997.

The speed of the reorganization and liberalization of public services appears exceedingly hesitant and slow relative to some experiences abroad, but encouragingly ambitious when compared to the Brazilian past. Limiting the analysis to electricity and telecommunications,[41] the following paragraphs center on the reform of the market structure, the progress in realizing the divestiture program, and the creation of institutions charged with regulating tariffs, access, and conduct.

So far, the attention paid to the break up of utilities, functional separation of competitive and non-competitive activities, and access liberalization to networks seems limited. In electricity, most generation (but not Brazil’s stake in Itaipú nor the nuclear plants) and distribution companies are slated for sale by the end of the century. The 1993 reform eliminated the CRC,

[38] A policy announced in 1992 to incrementally raise average rates 40 per cent in real terms was discontinued amid the adoption of the Real. In 1997 a major rebalancing took place, causing local measured service charges to increase 61 per cent and monthly residential charges 270 per cent.

[39] “Perda de energia cresce 64% nos anos 90”, *Folha de S. Paulo*, 7 May 1997. Energy losses are around 4 per cent in the US, 6 per cent in the UK, and 8 per cent at Chilectra (“Copel: Charged for Growth”, *Dresdner Kleinwort Benson Research*, June 1997).

[40] According to a study by the Asociação Brasileira de Infrastructura e das Industrias de Base (“Brazil: Talking big”, *Latin American Economy and Business*, September 1997).

[41] The 1997 petroleum law broke up Petrobrás monopoly in production and drilling; created an agency to set up rules for Brazil’s production and sale of oil and natural gas; and eliminates cross subsidies over a three-year transition period.

allowing individual companies to set their own prices conditional upon approval by the regulatory entity; created a transmission system (SINTREL) to unify the national grid and provide open access to all suppliers; and provided for unbundling of Eletrobrás's assets. A report commissioned by the government to an international consultancy and released in September 1997 recommends some standard measures for electricity privatization, such as gradual de-verticalization, creation of a wholesale power market, and operation of the transmission network by an independent operator (possibly to remain state-owned). In the meanwhile, however, large cross-subsidies still remain in place, transmission prices do not fully reflect user costs, interconnection conditions have not been specified so far, plans for instituting a pool market for energy lag behind schedule, and no firm consensus has emerged concerning the optimal level of vertical and horizontal integration at a number of large utilities.[42] A further difficulty is associated with the introduction of franchising mechanisms for the allocation of water rights, the lack of which would prevent open entry and long-term viability of competition, while also distorting comparisons with other energy sources such as gas.

A master plan for telecommunications and postal services (PASTE) was released in late 1995, pointing to the benefits of competition and privatization in order to hit the target of almost doubling the number of phone lines. The telecommunication law, however, took a long while before it was finally approved by Congress in July 1997. It is still unclear whether Telebrás will be split into a handful of regional operators, which can prospectively enter into reciprocal competition; when fixed telephony will be privatized; when the monopoly of Telebrás will be eliminated; and what will be the status of the long-distance carrier Embratel. By early October 1997, authorities appeared to have reached a consensus on grouping the 27 existing operators in three separate holdings, to be sold by mid-1998, establishing Embratel as a separate holding, and carving up mobile telephony in nine regional A-band operators competing with private concession-holders.[43]

While the number of privatizations -- i.e. transfer of both control and fixed and financial assets -- has been limited so far, the very fact that some investors have shown up is *per se* surprising given the vagueness of the regulatory framework. Due to Brazil's history of high-inflation, uncertainty concerning the automaticity of rate adjustments under the RPI-x formula chosen for the privatization of Escelsa and Light and the embryonic phase of the regulatory framework discouraged some foreign investors that had shown initial interest.[44] Following a clarification of such norms, Cerj was sold at a 29 per cent premium over the minimum amount

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[42] In principle, vertical unbundling -- involving separation of grid operation from production, transmission and distribution -- is the only way to ensure competition in electricity generation and supply as well as free access to the network. At the same time, horizontal unbundling -- involving the sale of production plants and distribution networks to several private companies -- could allow "yardstick" regulation based on the comparative performance of independent companies. In Brazil, separating accounting and management of generation, transmission, and distribution activities has been uncontroversial, the problem is rather the ownership break-up. Pinto (1997) considers that unbundling Cesp would prevent the government from pocketing the control premium, while *O Globo* (1997) suggests that the unbundling of Furnas and Eletrosul would disperse technological skills.

[43] "Telebrás será dividida em três e vendida até junho de 1998", *O Globo*, 3 October 1997.

[44] "EDF a remporté la privatisation de l'électricité dans l'Etat de Rio de Janeiro", *Le Monde*, 22 May 1996.

asked. In late 1996, one third of CRT, the only telecom operator controlled by a state, fetched almost 55 per cent more than the minimum price; on the other hand, the program to award concessions for cellular B-band licenses, to compete with existing services offered by Telebrás, finally took a slow start in 1997, and suffered a minor setback when no bid was received for the Northern Amazonia region.[45]

Despite a heated debate and several law proposals, reform of conduct regulation is still at the starting blocks. Open issues in the reform of conduct regulation include the designation of regulatory authorities, the definition of their powers, the choice of the tariff-setting formula, the fora to arbitrate controversies, and the role of the existing antitrust authority in monitoring access to networks and competition in the liberalized service markets. The literature on the politics of regulation has traditionally focused on two issues, namely *a*) the degree of discretionary power enjoyed by the regulator, and *b*) the game between the regulatory agency and the regulated firm, and therefore the risk that the former may be corrupted and/or the latter may capture the regulator (Noll 1989). In developing countries, agencies may be more permeable to the temptation of kick-backs, as the state is weak and civil servants' salaries are often low in absolute terms and always lower than in regulated firms. The recipe is therefore rather simple: introduce meritocratic recruitment, pay competitive salaries, and constrain the discretion exercised by intervention. A recent analysis of the Chilean case arrives at similar conclusions, arguing that although the separation of regulator and provider is an important institutional factor facilitating the autonomy of the regulatory process, other important features are the process to nominate and remove the top officials of the regulatory agency, the role of the executive in enacting the regulatory outcome, and the risk that an incomplete regulatory framework may jeopardize autonomy (Sánchez C. and Sanhueza 1997).

Early in office President Cardoso expressed the desire to create new industry-specific regulatory bodies in place of the ministerial departments (DENTEL and DNAEE) previously responsible for tariff setting. This choice, reflecting the international experience, was mirrored in the decision to grant greater operational independence to the Central Bank and to the existing regulatory agencies, CVM and CADE, the anti-trust authority. The electricity and telecommunications laws (1995 and 1997, respectively) merely laid out guidelines for the

[45] Cellular B-band 15-year concessions are governed by the 1996 *lei minima*. To avoid cherry-picking, Brazil was divided into two groups comprising ten regions; no competing group can bid for more than two regions and only one bid can be placed in each group. Bids are assessed according to the following technical criteria:

Item	Weigth (in percentage)
Tariffs	40
Start-up timeframe	20
Coverage area in square kms.	20
Number of municipalities covered	10
Activation wait time	10

Concessionaires are forbidden from adopting overly-competitive practices, such as providing subsidies or free handsets. The two most controversial issues of the "minimum law" relate to the destination of the concession fee and to the regulatory agency. The government had to back away from its plan to keep proceeds at the Treasury, giving way to Telebrás request to keep the fee. Opposition parties, for their part, filed a lawsuit claiming that the unconstitutionality of awarding concessions before an independent regulatory agency is established.

establishment of ANEEL and ANATEL, and in the case of ANEEL two years have elapsed but the concrete birth of the new energy agency is still embroiled amid discussions about environmental regulations of water rights, the staff salary levels, and the way to insulate the agency from political interference.[46] Nonetheless, limiting the discussion to the regulation of telecommunications services, some broad considerations can be advanced, based on the international experience (Table 10) and the theoretical framework proposed by Galal and Nauriyal (1995). A positive feature of the Brazilian system is the fact that the regulatory regime is embodied in a law, thus making it more difficult to change it without a serious debate. On other features, related to the regulators' ability to access information, provide efficiency-enhancing incentives to the firm, and institute safeguarding mechanisms to protect it against expropriation, the 1997 law falls a bit short of the international best-practice. The pricing formula is left unspecified, explicit conflict resolution mechanisms are not spelled out clearly, and the introduction of yardstick regulation to put the "baby-Brás" in indirect competition has not been planned so far.

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[46] "Aneel é motivo de disputa para ambientalistas", *Gazeta Mercantil*, 6 June 1997. Directors are appointed by the President, with the consent of Senate, for fix mandates outliving the administration's terms of office, and they cannot be removed unless under proper justification, and agencies receive off-budget financing.

Table 10. The regulatory framework in telecommunication: Brazil in comparative perspective

	Brazil	Argentina	Chile	Italy	United Kingdom
Industry structure					
local	*regional monopoly*	*regional monopoly*	*regional monopoly*	*free entry*	*free entry*
long-distance	*regional monopoly*	*regional monopoly*	*free entry*	*free entry*	*free entry*
Regulatory agency	ANATEL	CNT	SUBTEL	?	OFTEL
creation	*law*	*decree*	*law*	*law*	*law*
composition	*5 members*	*6 members*	*1 member*	*9 members*	*1 member*
nomination	*President of the Republic*	*President of the Republic*	*President of the Republic*	*government and Parliament*	*Secretary of State*
removal process	*special government body*	*special government body*			*Secretary of State*
Autonomy					
funding	*yes*	*yes*	*no*	*no*	*no*
pay-scale	*to be determined*	*same as civil service*	*same as civil service*	*same as central bank*	*same as civil service*
operational	*[can only be rated* ex post*]*	*low*	*limited*	*[can only be rated* ex post*]*	*high*
Powers regarding					
frequency allocation	*yes*	*yes*	..	*no*	*no*
licensing	*yes*	*shared*	*yes*	*no*	*yes*
technical standards	*yes*	*shared*	*yes*	*no*	*shared*
tariffs	*yes*	*no*	*shared*	*yes*	*only on the incumbent*
interconnection fee	*unclear*	*determined by CNT*	*published by SUBTEL*	*determined by agency*	*when parties do not agree*
Relationship with the anti-trust entity	Competition matters referred to the CADE	Unclear	Competition matters referred to the Fair Trade Office	Competition matters referred to the Autorità garante	License changes referred to the MMC, binding decision
Main statutory goals	Universal service, competition, compatibility with country's development	Universal service, prevention of anti-competitive behavior including unfair subsidies	Proposes national telecommunication policies, competition		Universal service, effective competition, customers' interest
Services covered					
fixed telephony	*yes*	*yes*	*yes*	*yes*	*yes*
mobile telephony	*yes*	*yes*	*yes*	*yes*	*yes*
cable TV and radio	*no*	*no*	*no*	*yes*	*shared*
Appeal procedure	Unclear	Judicial	Arbitration		Judicial

Sources: *Lei geral das telecomunicações brasileiras* and *Regulamento da agência nacional de telecomunicações*, Stafilidou (1996), and Urbiztondo *et al.* (1997).

The co-ordination between regulatory authorities is a final issue which remains to be clarified in the run-up to the privatization of public utilities concerns. Although competition between regulators has been sometimes advocated, concentration of regulatory powers within a few, well-co-ordinated institutions may lead to significant economies of scale and avoid inconsistencies that may induce consumers and investors to exert "regulatory arbitrage" between services which are close substitutes (e.g. rail and air transportation, gas and electricity supply, or different telecommunication media).[47] Having chosen the former solution, admittedly in line with all foreign countries' experience, Brazil has now to be cautious in order not to forfeit some benefits from economies of scope, as well as the growing assertiveness of the CADE. Despite its creation as early as in 1962, CADE's action remained subdued for many years, but has more recently attracted a lot of attention through some controversial decisions.[48] As far as the privatization of CVRD in particular is concerned, in a submission to the Senate the CADE argued that only in three out of more than a dozen business lines there was no risk of abuse of market power,[49] and launched an inquiry into allegations of a price-fixing cartel in the steel industry, pre-existing the CSN's acquisition of CVRD but possibly aggravated by the fact that CVRD owns a stake in Usiminas, CSN's biggest rival.[50] In any case, regulatory powers should remain circumscribed to tariffs and standards, while the defense and promotion of competition in all areas should be left to the CADE.

4. Conclusions

The wave of state divestitures reached Brazil later than the rest of Latin America. State intervention, which possibly served Brazil well (and better than other industrializing countries) until the 1970s, became increasingly inefficient, as improper goals were imposed on public enterprises and as they became a source of employment and political support. During the 1980s, ill-faded attempts of macroeconomic stabilization failed to acknowledge the fiscal roots of the crisis. A supporting coalition failed to emerge, as no political force full-heartedly embraced the reform manifesto, and economic agents that in other countries have been usually vocal in advocating state retrenchment had their own agenda, deriving benefits from hyperinflation (in the case of bankers) and state subsidies (in the case of industrialists). In this scenario, it does not come as a surprise that state managers could delay until 1990 the start of a large-scale privatization program.

Actual sell-offs followed an erratic pathway in the early part of the decade, as the Collor government was rapidly ousted from office and the Franco administration embraced privatization only reluctantly. A rather coherent policy plan, however, had already been in place for a number of years when the Cardoso administration, within the wider framework of the Real plan, started giving to the divestiture process a high priority as a measure to renew

[47] For example in Chile, see Blanlot (1993).
[48] Following the Colgate's acquisition of Kolynos, a toothpaste company, giving the combined group a 80 per cent of the Brazilian market, the CADE ordered the sale of part of the stock and banned the Kolynos brand for four years to give competitors a chance to establish themselves. In 1997, two separate joint ventures between US and Brazilian breweries (Miller and Brahma, and Anheuser-Busch and Antarctica, respectively) were both blocked.
[49] "Privatizar sem monopólio", *Folha de S. Paulo*, 8 May 1997.
[50] "Brazil probes claim that steel groups run price-fixing cartel", *Financial Times*, 16 June 1997.

with growth. The decision to give a co-ordinating role to the BNDES, in particular, has proved appropriate, partly shielding privatization from excessive political pressures and allowing policy-makers to exploit technical skills and competences built up over a number of decades. In this context, the government finalized the process of retrenchment from manufacturing, already near completion in steel and petrochemicals, by divesting of two symbolic companies such as Embraer, the aircraft manufacturer founded by the Air Force, and, especially, CVRD. The degree of transparency has been adequate, as accusations of unfair practice that have marred, for different reasons, privatizations in countries as diverse as Argentina, France, and Mexico have not arisen. And the fiscal treatment of privatization receipts had been in line with the practices advocated by international organizations.

Notwithstanding such early positive results, many features of both the privatization plan and its implementation are still open to question. First and foremost, international experience shows that efficiency gains are often hampered by little liberalization and that it is easier to liberalize before rather than after privatization, partly because belated liberalization implies a breach of commitments taken with shareholders. Market opening would make it possible for the telecoms and electricity sectors to adjust to new market conditions, with incumbents possibly challenged by new competitors, while thorough regulatory reforms in the domain of public service provision would allow authorities to establish their credibility. Moreover, a well-defined regulatory framework is essential for maximizing proceeds and for minimizing the burden put on authorities in regulating non-competitive behavior. In designing such a framework, uncertainty and discretion should be minimized: tariffs should be reviewed at fixed terms, possibly consistent with both the life-span of investment projects and the long-term contracts between independent producers and suppliers that usually replace vertical integration. The British experience shows that, even within a price-cap framework, excessive discretion in setting tariffs may lead to share price volatility, investment distortions and regulatory capture. All these lessons have certainly not been lost on Brazilian policy-markers, but transforming them in actual policy measures is exceedingly slow. So far privatizations have not been used as an opportunity to open up legal or *de facto* monopolies to competition and regulatory reform has been slow. As regards in particular electricity, the peculiar web of ownership ties linking the federal government and local state authorities means that co-ordinating decisions ahead of privatization must respond to the agenda of different politicians, that may vary in their ranking of economic preferences and immediate political priorities.

The consequences in terms of the ownership structure resulting from privatization are equally uncertain. Despite calls for creating people's capitalism and spreading ownership, reforms necessary to make equity investment more tempting and enlarge the pool of investors have not been introduced. Brazilian authorities have so far aimed at transferring control of each company through competitive bidding to a rather large pool of different investors, most often Brazilian conglomerates, banks, and semi-public pension funds. The participation of diversified business groups to privatization, in particula, has so far been rather limited, reflecting their smaller size, compared with similar countries, and the difficulties met in assuring the transfer of control between generations. This is in principle an efficient solution, compared with the selection of winners through often murky procedures as in Argentina and Mexico. But the

nature of the investors that are substituting for state ownership also calls for reforms. As regards banks, in spite of a few acquisitions by foreign investors, the system remains vulnerable and public institutions still intermediate a sizable chunk of deposits. In this context, the rise, albeit slow, of bank-industry ownership links should be a cause of concern, as should be the rising importance of semi-public institutions like the pension funds of the largest SOEs.

More generally, but equally importantly, the challenge for Brazilian policy-makers is to strengthen, or build from stretch when necessary, independent, competent, and assertive state institutions. Brazilian high-inflation capitalism was shielded from foreign competition and most often based on exceptions rather than rules. Following the ongoing fall of barriers and the return of macroeconomic stability, establishing and maintaining private sector confidence, and thereby laying the basis for sustained growth, calls for reforms fostering public sector transparency and accountability. In the past, the presence of isolated areas of bureaucratic efficiency could not hide the fact that Brazilian public administration and judiciary were dominated by patrimonialism, corruption, the capture of regulatory institutions, and an overall lack of accountability. The very movement toward structural reforms may contain the seeds of optimism, but the risk obviously remains that the agencies charged with supervising key sectors such as energy and telecommunications simply become new *bolsões de eficiencia*, in a sea of old-style public administration. This danger is also maximized if the law leaves excessive interpretative discretion. While at this point any analysis has necessarily to be highly conjectural, three elements allow a cautious optimism regarding the transition to regulatory capitalism. First, the fact that the Brazilian economy, being much more open than in the past although still less than other industrializing countries, benefits from the discipline deriving from international competition. Second, the apparently new found consciousness by Brazilians of the benefits of macroeconomic stability as the basis for sustained growth,[51] and the resulting incentives for politicians to shy away from populist policies. And third, the fact that Brazil, being a very late comer in structural reforms, may avoid some of the mistakes of other countries, such as Argentina and Mexico in the regional context, where the cart of fast sell-offs was put before the horse of institutional strengthening.

[51] The August 1997 CNI/Ipobe polls on public opinion's economic views shows that exactly half of the respondents expect quality improvement from privatization. Although the question is formally not the same, this percentage is similar to that in favor of privatizations in Argentina in 1989 (Di Tella 1992, p. 335).

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