

## THE FUTURE OF PRIVATIZATION IN BRAZIL: REGULATORY AND POLITICAL CHALLENGES

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**ABSTRACT:** *In 2018, year of presidential elections, the Brazilian Federal Government prepared to privatize the biggest state owned company in Brazil, Eletrobras, first Latin American and world's fourth power supply industry. It also represents the largest single privatization transaction in the entire Brazilian history, estimated in BRL 20 billion (\$6 billion, approximately). What are the regulatory issues involving privatization? How does it work in Brazil? These are questions we addressed in this single case through content analysis of extensive Brazilian official documents, such as Laws, sectorial and government agencies' norms and deliberations. We also investigated the offspring of privatization in Brazil, to provide a comprehensive understanding of the current transaction scenario. Finally, managerial recommendations and future research on the topic are presented.*

**KEYWORDS:** Brazil, Privatization, Regulatory environment

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### INTRODUCTION

The present case investigated the regulatory aspects of privatizations in Brazil, through qualitative single case study, which unit of analysis are the respective legal aspects of the transactions.

We reported the legal basis for the privatization, comparing rights and other indicators among them, to foster a larger perspective on the subject, and to provide subsidies to further analysis and discussion.

Privatization is a state participation reduction, or a power decentralization, through the selling of tangible assets or concessions to the private sector.

The implications for the society in general represent a great deal of amount, since there are approximately 150 state owned companies, and one of them, Eletrobras worth more than 20 billion, the biggest of Brazil (IBGE, 2018).

We analyzed and discussed the inedited legal aspects of privatization in Brazil, promoting the debate under the subject studied, criticizing some obscure points in golden share veto, for instance (Dias et al, 2014; Dias, Teles and Duzert, 2018; Dias and Navarro, 2017), and adding useful recommendations, the novelty on a subject widely studied in Brazil.

During the XX century, Nazi Germany (1930-1933), pressured by the economic chaos brought by the 1929 Great Depression, and pressured by the Weimar State, launched a massive privatization project. Railways, steel and mining companies, banks, and so on (Sweezy, 1940, 1941).

Therefore, the term “privatization” became popular when *The Economist* first used it to describe the Nazi economic policy (Edwards, 1995).

## METHODOLOGY

The present case study investigates the Brazilian Privatization Laws as the unit of analysis (Yin, 1988). Through extensive literature review, content analysis, official documents analysis, Laws, as well as search for secondary data available at the BFG agencies.

Primary data collected through current enforced legislation on the Privatization Laws, remarkably the Law 8.031/90 the first Law on privatization, later revoked and substituted by Law 9.491/97, which extended the powers for the golden share veto, for instance. Later substituted for Law 10.303, from October 31, 2001, to be further investigated.

## Background

Ancient Brazilian Imperial governments (1822-1889), controlled all aspects of civil and public arenas. Regarding financial activities, the first Brazilian Bank (*Banco do Brasil*), in 1808 and lately *Caixa Econômica* in 1861, the last one under Law 1.083, from August 22, 1860, under imperial D. Pedro II regime (Costa Neto, 2004).

In the first half of the XX century, the biggest state owned industries in Brazil were founded under president Getulio Vargas first administration (1930-1945): the national steel company, or *Companhia Siderúrgica Nacional* (CSN), in 1940; the mining company *Companhia Vale do Rio Doce* in 1942 (CVRD); the Electric power company, *Companhia Hidro Elétrica do São Francisco*, in 1945. On Getulio Vargas' second administration (1951-1954), it was founded the largest Oil & Gas industry in Brazil, *Petróleo Brasileiro S/A* (Petrobrás), in 1953. To foster Brazilian industry, the *Banco Nacional de Desenvolvimento Social* (BNDES), or the Social Development National Bank, was created in 1952, following the model of the North American Export-Import Bank of the United States (Eximbank), which was in turn founded on Roosevelt administration, in 1934 (Eximbank, 2018)

The cornerstone of the Getulio Vargas administration was intense state control. The Brazilian Labor Laws were established (Brasil, 1943), and the bureaucratic apparatus created. After the Vargas' suicide, on August 1954, a period of large industrialization effort took place, under the Juscelino Kubistcheck administration (1955-1960).

Despite its differences, both administrations were ruled under a presidentialist form of government, later substituted by a turbulent parliamentary system (1961-1963), and military dictatorship (1964-1988). This period in Brazilian history was characterized by intense power centralization and government direct interference on the economy, especially on state owned companies.

Brazilian economic development, therefore, depended exclusively on government external indebtedness, at that period. Brazilian economy, then, became dependent of International Monetary Fund (IMF), and its prohibitive loan interests, especially in 1980s, where a great inflation and economic crisis took over the Brazilian economy. Annual inflation rate reached 330 percent in average during the 1980s (Brasil, 2018). Privatization, then, was an alternative to solve the increasing governments dependence on IMF foreign capital.

The first privatized companies in the Brazilian history were Usiminas and Usimec, both steel companies from the Minas Gerais state, on October 24, 1991, almost eighteen months after the law enforcement. In 1991, the total of six companies were privatized. From 1991 to 2006, however, additional 44 companies have been privatized, as shown in Table 1.

In 2018, the Plan Ministry (*Ministério do Planejamento*) has devised 57 privatizations in one year, more than in the previous fifteen, including Eletrobras, the biggest electric power industry in Brazil, estimated in BRL 20 billion transaction (MPlan, 2018).

The most important Brazilian privatizations, since 1990 are listed, as follows: (a) the steel company, *Companhia Siderúrgica Nacional* (CSN), acquired on April 2, 1993 by Benjamin Steinbruch from Grupo Vicunha, for \$ 1.2 billion. On December 7, 1994, the aeronautics company Embraer (*Empresa Brasileira de Aeronáutica*), was sold to the Bozano Simonsen group, for \$ 100 million. On May 6, 1997, the biggest mining company in the world, *Companhia Vale do Rio Doce* (CVRD), was sold by \$ 3,3 billion to the Brazilian Consortium. Finally, *Telecomunicações Brasileiras S.A* (*Telebra*), which encompassed other twelve minor companies, was sold by approximately \$ 2 billion, on July 29, 1998 (see Table 1).

**Table 1: Brazilian companies privatized from 1990 to 2006.**

SIGLA	NOME DA EMPRESA	DATA DE EXCLUSÃO
CBEE	Comercializadora Brasileira de Energia Emergencial - Extinta pelo Decreto nº 5826/2006.	30.06.2006
BEC	Banco do Estado do Ceará S.A. e uma subsidiária (BEC-D TVM), adquirida pelo Bradesco.	21.12.2005
PAR	Petrobrás Argentina S.A. incorporada pela Petrobrás Energia S.A.	18.02.2005
EG3	Eg3 S.A. incorporada pela Petrobrás Energia S.A.	18.02.2005
BEM	Banco do Estado do Maranhão S.A. e três subsidiárias (BEM-SG, BEM-VTV, BEM-D TVM), adquirida pelo Bradesco.	10.02.2004
BEA	Banco do Estado do Amazonas S.A.	24.01.2002
BEG	Banco do Estado de Goiás S.A. e duas subsidiárias (BEG/DTVM e Sis plan)	04.12.2001
BANESPA	Banco do Estado de São Paulo S.A. e cinco subsidiárias	20.11.2000
DATAMEC	Datamec S.A. - Sistemas de Processamento de Dados	23.06.1999
GERASUL	Centrais Geradoras do Sul do Brasil S.A.	15.09.1998
TELEBRÁS	12 novas controladoras, abrangendo todas as empresas que compunham o Sistema TELEBRÁS (EMBRATEL, 27 empresas de telefonia fixa e 26 de telefonia celular)	29.07.1998
MERIDIONAL	Banco Meridional do Brasil S.A. (e cinco subsidiárias)	04.12.1997
CVRD	Cia. Vale do Rio Doce (e 13 subsidiárias)	06.05.1997
LIGHT	Light Serviços de Eletricidade S.A.	21.05.1996
ESCELSA	Espírito Santo Centrais Elétricas S.A.	11.07.1995
EMBRAER	Empres a Bras. de Aeronáutica S.A.	07.12.1994
EAC	Embraer Aircraft Corporation	07.12.1994
EAI	Embraer Aviation International	07.12.1994
NEIVA	Indústria Aeronáutica Neiva S.A.	07.12.1994
CARAIBA	Mineração Caraíba Ltda.	28.07.1994
PQU	Petroquímica União S.A.	25.01.1994
AÇOMINAS	Aço Minas Gerais S.A.	10.09.1993
COSIPA	Cia. Siderúrgica Paulista	20.08.1993
ULTRAFÉRTIL	Ultrafertil S.A. Ind. e Com. de Fertilizantes	24.06.1993
CSN	Cia. Siderúrgica Nacional	02.04.1993
FEM	Fábrica de Estruturas Metálicas S.A.	02.04.1993
ACESITA	Cia. Aços Especiais Itabira	23.10.1992
ENERGÉTICA	Acesita Energética S.A.	23.10.1992

FASA	Forjas Acesita S.A.	23.10.1992
GOIASFÉRTIL	Goiás Fertilizantes S.A.	08.10.1992
FOSFÉRTIL	Fertilizantes Fosfatados S.A.	12.08.1992
CST	Cia. Siderúrgica de Tubarão	23.07.1992
CNA	Cia. Nacional de Alcalis	15.07.1992
ALCANORTE	Alcalis do Rio Grande do Norte	15.07.1992
COPEL	Cia. Petroquímica do Sul	15.06.1992
PETROFLEX	Petroflex Indústria e Comércio S.A.	10.04.1992
AFP	Aços Finos Piratini S.A.	14.02.1992
SNBP	Serviço de Navegação da Baía do Prata	14.01.1992
COSINOR	Cia. Siderúrgica do Nordeste	14.11.1991
COSINOR DIST.	DIST. Cosinor Distribuidora S.A.	14.11.1991
MAFER SA	Mafersa S.A.	11.11.1991
CELMA	Cia. Eletromecânica	01.11.1991
USIMINAS	Usinas Siderúrgicas de Minas Gerais S.A.	24.10.1991
USIMEC	Usiminas Mecânica S.A.	24.10.1991

Source: Ministry of Planning, 2006. Reprinted under permission.

### Privatization in Brazil: Legal aspects

The first Brazilian privatization Law was enforced on April 12, 1990 (Law 8.031/90), under the Fernando Collor de Mello administration (1990-1992). Collor was the first impeached president in the Brazilian history. When he took the presidential office, Brasil had 1,972.91 percent inflation in one single year, the worst inflation in the Brazilian history (IBGE, 2018). One of the main Collor's initiatives was the creation of the national desestatization plan, through Law 8.031/90, which stated the objectives of the privatization, designed to

I - reorder the state's strategic position in the economy, transferring to private initiative activities unduly exploited by the public sector;

II - contribute to the reduction of public debt, contributing to the improvement of public sector finances;

III - allow the resumption of investments in companies and activities that may be transferred to the private sector;

IV - to contribute to the modernization of the industrial park of the Country, increasing its competitiveness and strengthening business capacity in the various sectors of the economy;

V - enable the public administration to concentrate its efforts on activities where the presence of the State is fundamental to the achievement of national priorities;

VI - to contribute to the strengthening of the capital market by increasing the supply of securities and democratizing the ownership of the capital of the companies participating in the Program (Brasil, 1990, article 1).

In sum, the objectives were: (a) to recognize that BFG should transfer the private sector the "unduly exploited" activities (Brasil, 1990, art 1, item I); (b) to reduce the public debt; (c) to modernize the entire industry; (d) to attract foreign capital and investments for the newly privatized companies.

Law 8.031/90, Article 2 described which companies could be privatized: (a) controlled companies, directly or indirectly, by the Union such as state owned and mixed companies, (BFG controls minimum 51 percent) (Brasil, 1990, Art. 2, item I); or (b) companies "created

by the private sector and that, for any reason, passed to the direct or indirect control of the Union” (Brasil, 1990, Art. 2, item II). All privatizations are accomplished through public auctions, as laid down in Law 9.491/97, Article 2, paragraph 4. (Brasil, 1997).

However, despite the privatization, BFG inserted a subtle control mechanism through the creation of special class of capital stock, introducing in practice, a golden share veto power (Dias, Teles and Duzert, 2018). It is described on Article 8:

Whenever there are reasons that justify it, the Union shall directly or indirectly hold shares of a special class of the capital stock of privatized companies, which will confer veto power on certain matters, which shall be characterized in the bylaws of the companies, in accordance with the provisions of art. 6, item XIII and §§ 1 and 2 of this law (Brasil, 1990, Article 8).

The Law 8.031/90 had some limitations. Only state owned or mixed companies could be privatized, following that rule. Other state companies, like state banks and highways, for example, were out of the privatization Law. Regarding banks, seven years later the BFG would issue a new Law to accommodate financial institutions to be sold.

Regarding highways, railways, waterways, airports, and so on, BFG would privatize them only partially, without selling the assets directly, but instead through *concessions* or *permissions*, subject of a different Law nº 8.987 from February 13, 1995. *Concessionárias* or *permissionárias* (legal contractors), after winning a public bidding contest (*Concorrência pública*), would operate by collecting toll fees for a limited amount of time (Brasil, 1995). Differently from privatization, where the assets are sold to the private sector, in a *concession*, the payment entitlements are leased out via a contractual clause as referred to in Article 2, Law 8.987/95.

For instance, on March 2018, 15 percent of the Brazilian highways were under the private sector’s *concession*, covering up to 9,700 km, approximately, equivalent to 21 highway sections. BFG intends to privatize additional 8,000 km (G1, 2017).

The Provisory Measure (*Medida Provisória*) no 1481-52, from August 8, 1997, gave birth to the privatization Law 9.491, from September 9, 1997, which in turn, has been modified through decrees nº 6.026/2007; nº 6.380/2008; nº 6.502/2008; nº 7.267/ 2010, and finally nº 8.094/2013.

Basically, Law 9.491/97 included “state public financial institutions” (Brasil, 1997, article 2, paragraph IV), within the privatization list. The article four of the same Law, limited the modalities of privatizations:

- I - disposal of equity interest, including stock control, preferably through the pulverization of shares;
- II - opening of capital;
- III - capital increase, with waiver or assignment, total or partial, of subscription rights;
- IV - sale, lease, lease, lending or assignment of goods and installations;
- V - dissolution of companies or partial deactivation of their ventures, with the consequent disposal of their assets;

VI - concession, permission or authorization of public services.

VII - settlement, remission of jurisdiction, exchange, assignment, concession of real right of resolvable use and sale by sale of real estate in the domain of the Union (Brasil 1997, article 4).

If, by any circumstance, the winner of the public auction was declared later unfit to fulfill its legal obligations, there was nothing could be done, except to reschedule a new auction (Brasil, 1997, article 4).

Later, in 2016, Law 13.360 included the second best ranked, without need for a new auction (Brasil, 2016, article 4), increasing the effectiveness of the privatization process.

One of the main differences from the previous Law 8.031/90, was inclusion of state public financial institutions to be privatized (who had become a part of the Law 8.031/90), through the article 8 (Brasil, 1997). In 1990, only mixed or state owned companies could be privatized (Brasil, 1990). In 1997, also banks and other financial institutions could be privatized (Brasil, 1997). In 2001, the range was finally extended to corporations (Brasil, 2001).

Then, through Law 10.303 from October 31, 2001, the *special class shares*, started to encompass a greater number of companies, including Corporations or *Sociedades Anônimas* (SA). Law 10.303/2001 added provisions in Law No. 6,404, from December 15, 1976, which regulates Brazilian Stock Corporations, and Law No. 6,385, from December 7, 1976, which regulates the securities market and creates the Stock Market Commission, or *Comissão de Valores Mobiliários* (CVM) (Brasil 2001).

Regarding the special class of shares (which provide BFG veto power), Law 10.303, article 17, subparagraph §7 states

In the companies that are subject to privatization, special class preferred shares may be created, exclusively owned by the privatizing entity, to which the bylaws may confer the powers it specifies, including the power of veto to the deliberations of the general meeting on matters to be specified (Brasil, 2001, article 17, §7).

In sum, despite the desestatization program being active, the BFG kept special powers, regarding the privatized companies golden share veto power. One example, Embraer, has been recently explored by Dias, Teles and Duzert (2018). It is not allowed to: (a) change the Company's name or logo; (b) create and / or to modification military programs, involving or not the Federative Republic of Brazil; (c) Third-party training in technology for military programs; (d) Interruption of the supply of maintenance and replacement parts for military aircraft; e) Transfer of control of the Company (Dias, Teles and Duzert, 2018). The BFG special veto powers can be observed on Table 2, as follows:

**Table 2: Brazilian golden share legal substantiation.**

Law	Article	Description
8.031/90	8	Golden share to state owned companies
9.491/97	8	Included Financial Institutions
10.303/01	17, paragraph 7	Included Sociedades Anônimas (Corporations)

Source: Dias, Teles and Duzert, 2018. Reprinted under authors' permission.

### Privatization in Brazil: future challenges

In 2018, BFG prepares 52 privatizations, including Eletrobras, the biggest electric power industry in Brazil, as aforementioned, which is a mixed economy company, and is a state-run, publicly-traded company controlled by the Brazilian government via the ministry of mines and Energy. Eletrobras, founded in 1962, to function as holding company of fifteen other electric power companies. It is responsible for 37 percent of the total Brazilian power generation, Eletrobras' plants have an installed capacity of approximately 42,080 megawatts e 164 plants – 36 hydro electrical and 128 thermoelectrically ones, along with two thermonuclear plants (Eletrobras, 2018). BFG expects to collect the amount of BRL 20 billion with Eletrobras privatization. BFG controls 51 percent of the company. According to the ministry of mines and energy, Fernando Coelho Filho,

In this proposal, there is no sale of Union action. We will pick up the plants, remove from the MP (provisional measure) 579, for this you need the law, to return them to Eletrobras. They will pay for the plants with resources acquired with the primary issuance of shares, which will be offered to the market, and Eletrobras pays the Union. This dilutes the participation of the Union and the Union loses control of the state. You cannot estimate, it's a lot of money, around R \$ 20 billion in collections. It will be enough to meet the fiscal need. It is possible to complete this process in six months (O Globo, 2018, p.1)

Therefore, BFG expects to launch a public offer on part of the controlled shares, to private initiative. However, Eletrobras debt is estimated in BRL 34,8 billion almost twice the sales price. BRG would still keep a BRL 14,8 billion debt due to Eletrobras' financial situation, if the business would indeed materialize.

### DISCUSSION

Privatization in Brazil is a hot topic, and controversial subject. On one hand, there is the BFG trying to solve its rising indebtness, and to improve public service effectiveness (Dias and Aylmer, 2018). On the other hand, some sectors of the society criticize such measures, arguing that Brazil is being sold out, and that the new owners do not pay a good service, like in the case of mobile services in Brazil (privatized in 1998, see Telebras privatization, in Table 1) . The

authors, as service consumers since before the privatization argue that the privatization had its merits, but the service is still poor and expensive, and there is a long way to improve them.

Lessons learned from this case, also suggests:

1. *Privatization is a sensitive case, and should get the popular approval through previous public consult.* The privatization process should be more transparent, especially on sensitive matters, such as electric power generating and distribution, given the importance of this segment to the whole country.

2. *The golden share veto power gives a leverage negotiation power to the BFG.* Dias, Teles and Duzert (2018) investigated how the BFG power veto was used in the failed Embraer's acquisition attempt by Boeing, and how golden shares provide leverage power in such negotiations. On the other hand, it increased dramatically the amount of bureaucracy among the private companies, under the golden share rule.

3. *Privatization is not the only solution to public indebtedness.* Important measures involve the reduction of government spending with civil service, associated to the productivity of civil servants, and especially Executive power spending on payroll and additional social security benefits (Dias and Aylmer, 2018).

4. *Privatization increases competitiveness among companies.* Conversely to the left wing political parties claims' in the past, the privatizations did not "destroy the public patrimony, or threatened the national sovereignty" (Exame, 2018) as largely foretold, on the contrary, it promoted effectiveness through intense competition among the new players from the private sector. Privatized companies, such as Embraer, continued to be examples of effectiveness and productivity, even after ten years privatized (Embraer is currently the third world's largest aircraft manufacturer).

5. *Privatization should be used carefully, and by all means to avoid corruption.* In president Dilma Rousseff administration (2011-2016), the second impeached president in the Brazilian history, there were more privatizations and concessions than all the predecessors. However, many transactions were fraudulent, and are being investigated by the Public Ministry (*Ministério Público*), on the *Lava Jato Operation*, the biggest anti-corruption and laundry money operation in the entire Brazilian history. For instance, the airport concessions, such as Viracopos (SP), Brasília (DF), Guarulhos (SP) and Galeão (RJ) airports. Odebrecht took Galeão (Rio de Janeiro airport) by BRL 19 billion, paying 294 percent more than the originally proposed by the BFG, and now responds for corruption scandals in Justice, with its president under arrest, Marcelo Odebrecht. The three first airports mentioned, which respective acquiring companies, Engevix, UTC Engenharia and OAS, are all responding in Justice for corruption at the same *Lava Jato operation* (O Globo, 2017).

6. *Crime doesn't pay. One day, they all will get caught.* Even the former president Luis Inacio "Lula" da Silva (2003-2011), one of the most popular president in recent years (from *Partido dos Trabalhadores*, or labor party, or simply PT) was accused of taking the bribe of BRL2,25 million, and later convicted for corruption, laundry money, and sentenced to nine years and six months of prison, on July 12, 2017, by Sergio Moro Judge, at Porto Alegre (RS). Lula, the defendant claimed innocence: "the only proof in this process is the proof of my innocence"(O Globo, 2017, p.1).

However, Sergio Moro Judge stated the opposite in the sentence: "the responsibility of a president of the Republic is enormous and therefore also his guilt when he commits crimes" (G1, 2017b, p.1).

Lula tried to appeal against sentence and was defeated on January 24, 2018, where three judges from the 8th Criminal Class of the TRF-4 (Federal Regional Court, or *Tribunal Regional Federal*), at Porto Alegre, Rio Grande do Sul (RS), the second instance of Lava Jato operation, rejected his appeal and voted unanimously (3x0) to uphold the sentence handed by Sergio Moro Judge, and increased the penalty from nine and a half years to 12 years and one month (The Guardian, 2018b). With the second conviction, the chances of Lula to run the presidential election in 2018 decreased dramatically, since he can be arrested at any time, turning impossible to a convicted in second instance and jailed person to run an elective position in Brazil. The future of privatizations is uncertain in 2018, at least until next October, when the presidential elections will take place.

The subject privatizations in Brazil is surrounded of suspicion, since scandal after scandal is daily revealed, especially with the *Lava Jato Operation*, and other corruption scandals. Privatizations are not the only solution to public indebtedness. For future research, effective alternative measures to fight public indebtedness are encouraged, as well as revisiting the case privatizations and Eletrobras, one of the promising biggest operations in the Brazilian history.

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