

The implicit agenda of a conservative patrimonial reform

LUIZ CARLOS DELORME PRADO LEONARDO WELLER¹



Although it was argued that the proceeds from privatisation would be invested in social reforms, from 1995 it became clear that those revenues generated an important inflow of international capital, to be used not for social investment, but rather to finance trade deficits and debt service. The economic results of privatisation were mixed, while in social terms they have been a failure.

The National Programme of Privatisation (PND) was created under the Collor Government in 1990 by Law 8.031/90. Two institutions implemented this programme: the National Council of Privatisation (CND) and the National Bank of Economic and Social Development (BNDES). The CND was the main planning council of the privatisation processes. It reported directly to the presidency and had ministerial status. The BNDES managed the National Privatisation Fund (FND), which is the trustee of privatisation revenues.

Objectives and official justifications of the PND

The privatisation programme was launched as one of the bold conservative structural economic reforms proposed by president Fernando Collor to end the economic crisis of the late 1980s. (The short Collor presidency was marked by accusations of corruption that led to his impeachment in 1992.) Succeeding presidents deepened the process. Privatisation officially had two main objectives:

- *Improve efficiency.* Privatisation policy assumes that the private sector is more efficient than the public sector. Supporters argued that increased productivity achieved through private entrepreneurship would spill over to the rest of the productive structure.
- *Reduce government expenditure.* By privatising the state companies, the State would no longer be responsible for investment (or losses). Therefore, the government would be able both to reallocate those resources to other areas, such as health and education, and to increase its budget surplus.

The implicit agenda of PND

The true reasons for privatisation became evident after the *Plano Real* was launched in 1994. Although the Cardoso government argued that the proceeds from privatisation would be invested in social reforms, from 1995 it became clear that those revenues would also help supply foreign capital funds to finance the huge current deficits caused by the exchange rate policy, which in turn was used to strengthen the currency and curb inflation. (See Table 1).

In order to maintain a stable exchange rate, it was necessary to import capital. In addition to privatisation revenues, the government obtained foreign capital through high interest on its bonds. Over time this forced the government to allocate more revenues to service its growing debts.

The PND worked in both these directions. While the resources deposited in the FND increased the government's revenue, foreign groups bought almost half of equity sold by PND. Therefore, the privatisation programme generated an important inflow of international capital, to be used not for social investment, but rather to finance trade deficits and debt service.²

1 Luiz Carlos Delorme Prado, Associate Professor of Economics, Federal University of Rio de Janeiro; IBASE's consultant. Leonardo Weller, Research Assistant and M.Sc student at Federal University of Rio de Janeiro.

2 There is some controversy about social expenditure in Brazil. See Sonia Draibe, «As Políticas Sociais nos Anos 1990», in Renato Bauman, *Brasil: Uma Década em Transição*, ECLAC, Campus, 2000.

TABLE 1

Current account (USD billions)										
YEAR	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
CC balance	6.1	(0.6)	(1.7)	(18.0)	(23.5)	(30.8)	(33.4)	(25.4)	(24.7)	(23.2)
CC balance/GDP	0.9	(0.8)	(0.9)	(2.8)	(3.2)	(3.8)	(4.2)	(4.8)	(4.1)	(4.6)

Source: Conjuntura Econômica/FGV

The privatisation process

From 1990 to 1992, 18 steel and petrochemical companies were sold to the private sector. During 1993 and 1994, PND privatised 14 companies, completing the transference of the Brazilian steel industry to the private sector. In 1995, the PND started the privatisation of public services, such as urban electricity and public transport firms. In 1996, the privatisation programme of companies owned by the federal states began. During 1995 and 1996, the PND privatised 19 companies. The privatisation process was extended to telecommunications in 1997, when PND revenues came to USD 26.3 billions, more than its combined revenues from 1991 to 1995.³ In 1998, the PND collected its largest revenues, USD 35.7 billion. During 1997 and 1998, the PND privatised most of the state companies. After 1999, the privatisation process lost steam, with revenue dropping to USD 4.2 billion in 1999. After increasing in 2000 to USD 10.2 billion, the programme's revenue fell to USD 2.8 billion in 2001 and to USD 2.0 billion in 2002. The PND completed the privatisation of the electricity sector in 2000. In 2001, the programme completed the telecommunications concession bidding. Privatisation in 2002 was in the banking sector. Of total PND revenues of USD 105.3 billion, USD 70.6 billion came from the privatisation of federal government companies, while the remaining USD 34.7 billion came from state (provincial) companies. Summing up, 65% of the revenue of the privatised companies belonged to the public service sector. Among those, 62% were in energy and telecommunication, 29% were in the productive sector and 6% in the financial sector.⁴ Foreign investors had an important role in the PND: 48.3% of all the resources invested in the programme was international capital. Americans, Spanish, Portuguese and Italian were the main foreign investors. (See Table 2)

Privatisation proponents appear to have lost political support for their policies. The loss of dynamism of the PND since 2001 is largely due to stronger public opposition to attempts to sell out large government companies such as *Petrobras*, *Banco do Brasil* and *Caixa Econômica Federal*. Another reason for the slowing pace of privatisation is increasing scepticism about its efficacy in areas such as electric energy, in the wake of the disastrous electricity shortage that plagued families and business during 2001.

3 Data from BNDES.

4 *Ibid.*

TABLE 2

Foreign investors in PND (USD millions)					
COUNTRY	PND	FEDERAL STATE - OWNED COMPANIES	TELECOMMUNICATIONS	TOTAL	%
USA	4,318	6,024	3,692	14,034	16.5
Spain	3,606	4,027	5,042	12,675	14.9
Portugal	1	658	4,224	4,882	5.7
Italy	-	143	2,479	2,621	3.1
Chile	-	1,006	-	1,006	1.2
Belgium	880	-	-	880	1.0
UK	2	692	21	715	0.8
Canada	21	-	671	692	0.8
Sweden	-	-	599	599	0.7
France	479	196	10	686	0.8
Others	1,903	908	532	3,343	2.7
Total Foreign Investors	11,210	13,654	17,270	42,134	48.3
General Total	30,480	27,949	28,793	87,222	100.0

Source: BNDES

Results of the privatisation process

From an economic perspective, the results of the privatisation process depend on each sector. The best efficiency gains were made in manufacturing companies, such as steel, mining, airplanes and petrochemicals. The most celebrated case is *Embraer*, a state owned aerospace firm that became one of the world's largest commercial airplane manufacturers after privatisation.

However, in the public service sectors results were mixed. There was some improvement in telecommunications, as the supply of fixed and mobile telephone lines increased sharply. In the process of modernising telecommunications, private firms sometimes imported technology and abandoned domestic expertise, in some cases using foreign manpower in place of the dismissed domestic engineers and technicians. The most famous case was *Embratel*, the government's main telecommunications holding company, which in June 1998 was sold to WorldCom, an American firm that went bankrupt after a major accounting fraud was revealed. *Embratel* was set up in 1969 to run all the interstate and international Brazilian telecommunications. Since its foundation, this company used satellites for international and domestic communication, and since 1985 it has had its own satellites. It was a pioneer in developing a huge optical fibre network in Latin America. The rapid growth of the Internet in Brazil was only possible because *Embratel* developed the infrastructure in Latin America. Their engineering also had a strategic role in the development of the Internet network and data transmission in Brazil. The new owner, WorldCom, does not seem to be a well-run company, as its recent financial problems have shown. What efficiency gains could this new owner have brought to a firm that had been one of the most professionally run and strategically capable Brazilian public companies?

Electric power and transmission companies have been only partially privatised. Privatisation is complete for public electricity distribution companies, most of which were state (province) owned. The performance of those companies after privatisation was mediocre, the quality of services was inconsistent, and the price charged for services increased enormously. Between 1996 and 1998, PND accomplished 18 of the 22 privatisation bids of electrical companies. During these years, average electrical tariffs increased 45%. Residential consumers got the largest increase of 65%, while tariffs to industries, the commercial sector and rural consumers increased respectively 30%, 31% and 25%.⁵ These increases were much higher than inflation in the same period.

Lack of public investment and overconfidence in the privatisation programme led also to the 2001 energy crises, which forced the country to go into an electricity rationing programme. The imbalance of supply and demand in this industry shows that the groups that bought the electric companies have not been investing enough. The electric system is based on hydroelectric power and depends on transmission over long distances. Consumers (about 47.2 million units) are concentrated in the industrialised Southeast States. The electric system must balance changes in generator power due to rainy seasons with the needs of the different regions. Because electricity demand has been growing faster than GNP, it takes a huge annual investment (BRL 6-7 billion per year – USD 2-2,34 billion) to keep pace with consumption. The level of investment in the electric system as

a whole, that is, including generator, transmission and distribution, was for 1994 only half the average level of investment of the 1980s. From 1980 to 1989 the annual investment in this sector was USD 12.6 billion. From 1990 to 1993 this was reduced to USD 8.1 billion. From 1994 on, it was USD 5.5 billion or less.⁶

In social terms privatisation has been a failure. The new owners laid off a huge number of workers. During the 1990s employment in the public sector was reduced by 43.9%.⁷ The group of companies originally owned by the state sector lost 546,000 jobs on all levels, from 1989 to 1999.⁸ Many experienced engineers and technicians were replaced by workers from (foreign) headquarters or from contract firms.⁹ Payroll expenditures were also reduced but at the same time the company began to pay much higher salaries for their foreign executives and advisers. The conservative argument that Brazil's well-trained workers would trade off low wage public jobs for well paid private ones was shown to be absolutely false. During the 1990s 48% of the new jobs created belonged to just three occupations: domestic employees, salesmen, and building construction workers. The growth of unemployment for people with eight or more years of education grew 620%, much more than the unemployment rate of people with less than one year of education, which grew 189%.¹⁰

Nor was the objective of using privatisation revenue to decrease government expenditure accomplished. Despite the fact that the government did not have to invest in privatised companies, the government's debt increased dramatically after 1994. Between 1994 and 2001 the domestic public debt grew 330%, from BRL 153 billion in 1994 to BRL 661 billion in 2001.¹¹ This was caused mainly by high interest being paid to attract foreign capital, but also by the sterilisation of monetary supply increases, through a policy of reserve accumulation, which was needed to guarantee capital account liberalisation.¹²

The external debt grew from USD 148 billion in 1994 to USD 226 billion in 2001, and government expenditure with payment of interests reached about 10% of GNP during 1999-2001. That is, resources from privatisation were too small (in view of the increased government expenditure required to pay the necessary interest, due to the large current account deficit) to keep a low exchange rate up to 1998. Finally, even though Brazil was compelled to change its exchange rate policy in 1999 after a financial crisis, exchange rate instability has persisted and the country now faces the prospect of another crisis.

Conclusion

The conservative patrimonial reform did not deliver promised benefits. A decade after the programme started, the results are mixed in economic terms, while in social terms – employment impacts and the costs for households and small businesses – they were negative. Except among entrepreneurs and the press, privatisation was never widely supported in Brazil. However, because the government was able to link the PND with its successful policies to control inflation, it was considered a legitimate economic policy. During the 1990s, and particularly up to the end of Cardoso's first term, public opinion was not strongly against privatisation. This began to change during his second term. The conservative economic plan was under strong criticism and public opinion was growing sceptical of mainstream economists' explanations for the failure of Brazilian economic development. Finally, the economic and financial crisis of the last two years has definitively discredited the conservative project. All presidential candidates in 2002 stated, in different degrees, that Brazil's economic model should be changed. ■

Instituto Brasileiro de Análises Sociais e Econômicas (IBASE)
<observatorio@ibase.br>

6 Data from Eletrobras.

7 Marcio Pochman, *A Década dos Mitos*, Sao Paulo: Editora Contexto, 2001.

8 *Ibid.*, p. 30. According to Pochman from 1989 to 1999 the unemployment rate in Brazil grew from 3% to 9.6% of the labor force. That is, the number of people looking for a job jumped from 1.8 million in 1989 to 7.6 million in 1999.

9 *Ibid.*, p.74, for a comparison between occupations, years of education and remuneration.

10 *Ibid.*, pp. 73-74.

11 Data from Banco Central do Brasil. Nevertheless, according to Castelar Pinheiro Public Debt was smaller than it would be without privatisation. See Armando Castelar Pinheiro, *A Experiência Brasileira de Privatização*, BNDES, Texto para Discussão 82, Rio de Janeiro, 2001.

12 «Sterilisation» neutralises the monetary expansion caused by increased capital inflows. Up to 1996 Brazilian Reserves of foreign currency grew. If all this increase were to be exchanged for reals, (and so increase the domestic monetary supply) this could have some nasty effects on the inflation rate. So the government offered public bonds with high interests rate to contract the domestic money supply.

5 Data from ANEEL (Electric Energy National Agency).