



PRESIDÊNCIA DA REPÚBLICA
Governo Fernando Henrique Cardoso

PRIVATIZATION ENTERS A NEW PHASE

BRASÍLIA, AUGUST, 1995

PRESIDÊNCIA DA REPÚBLICA
Governo Fernando Henrique Cardoso

**PRIVATIZATION
ENTERS
A NEW PHASE**

BRASÍLIA, AUGUST, 1995

Brasil, Presidente, 1995— (F.H. Cardoso)

Privatization Enters a New Phase.— Brasília: Presidência da República, Assessoria Especial, BNDES, 1995.

21p.— (Documentos da Presidência da República).

1. Privatização — Brasil. I. Cardoso, Fernando Henrique, Presidente do Brasil, 1991— II. Título.

CDD 354.81035

FOREWORD

The privatization program is an integral part of the reform of the Brazilian State. Its objectives are to achieve a lasting fiscal adjustment, to reduce government debt, to concentrate government activities on the social area, to stimulate the national industry's modernization and to strengthen capital markets by broadening their popular base.

The government has promoted the sale of state enterprises in the industrial sector and especially steel, petrochemical and fertilizer companies. The privatization of the electric sector began with the sale of ESCELSA in July, 1995. The Brazilian Privatization Program (PND) has yielded receipts of \$ 9,2 billion from the sale of state enterprises plus \$ 400 million from the sale of government minority corporate shares. In addition, the private sector has accepted responsibility for \$ 3.6 billion in outstanding debts. One must also consider the indirect benefits resulting from the privatizations: increased investment by the new private sector owners (including for environmental protection), more tax receipts, as companies that had previously lost money began to generate profits, new employment opportunities and, finally, improvements in the economy's overall productivity.

The Cardoso government improved the PND's decision process by creating the cabinet level National Council on Privatization (CND) and by making it directly accountable to the President. The CND has already taken important decisions to complete the priva-

tization of the petrochemical sector and, before the end of this year, to consolidate the privatization of the electrical sector and begin the privatization of the railroad and financial sectors. The privatization process of the Companhia Vale do Rio Doce has also been initiated and should be completed during the coming months.

The privatization program has entered a new, more dynamic phase. It is looking for private sector partners to overcome major infrastructure bottlenecks, notably in the electric energy, transportation and communications sectors. Opening these areas to new entrepreneurs will enable the State to dedicate itself more effectively to its regulatory functions. The government will be able to provide investors with clear regulations and greater security, guaranteeing the quality and continuity of public services.

The privatization process is a fundamental instrument in building a more prosperous and just Brazil in which the State focuses its attention and scarce resources on its traditional functions and on its regulatory obligations. Given a context of regulatory stability and of wide business opportunities, the private sector will certainly contribute decisively to the country's development.

JOSÉ SERRA
MINISTER OF PLANNING AND BUDGET

PRIVATIZATION ENTERS A NEW PHASE

Re-thinking the State's Role in the Economy

Brazil has radically altered its view of the proper role of a modern State. No longer is the government seen as a prime producer of goods and services, but rather as a regulatory agent that should focus its resources on the country's social needs. Privatizing the State's extensive productive network is an effective way to enhance the government's social role, to balance the budget, to reduce the public debt and to improve the competitive position of the nation's industry.

The steel sector is a good example of Brazil's changing economic structures. Throughout the last forty years, the Brazilian government invested \$26.1 billion in the steel sector, receiving in return dividend payments of only \$600 million. From 1992 until 1993 eight companies were privatized. The speed at which these companies turned their losses into profits was remarkable. Already in 1993, they were able to distribute dividends worth \$150 million. But the benefits to Brazilian society far exceed that number. In financial terms, the total sale of the steel sector approximated \$10.6 billion if one considers the \$5.5 billion from the sale of shares, the \$2.6 billion in debt assumed by the new owners, and the expected \$2.5 billion of new investment. In addition, efficiency improved substantially, about 2,500 new jobs were created, ownership was expanded and extended to the workers, and exports rose. The successful privati-

zation of the steel sector indicates the privatization program's massive benefits to Brazil.

In summary, the privatization program contributes significantly to the restructuring of the State by pursuing the following objectives:

- correcting the fiscal imbalance;
- focusing the government's activities on the social area;
- transferring to private management many activities considered "strategic" in the country's previous development model;
- stimulating the modernization and restructuring of the country's industrial sector; and
- strengthening the capital market by broadening its base.

The Phases of Privatization in Brazil

Privatization has been a part of the national agenda for many years. The first phase of the program (1981-89) was characterized by the privatization of companies that had been absorbed by the State due to their financial difficulties. At the time, the government had no intention of implementing a large-scale privatization program. Because this phase covered mostly small companies, it had little economic impact. The government received only \$723 million in privatizing thirty eight enterprises.

In 1990, the Collor government made privatization a fundamental part of its plan for structural reform. The government initiated this second phase by creating the Brazilian Privatization Program (PND). In the process, the privatization effort was enlarged significantly – thirty-four state companies and thirty two minority stakes were included in the PND. The sale of Usiminas alone, in October 1991, generated twice the revenues of all prior privatizations. During 1991-93, the PND focused on selling state

companies that had been considered strategic in the development model of the 1970s. That fact explains why the steel, petrochemical and fertilizer sectors had such a prominent role. During this period, the privatization currencies – debt for equity swap– were used almost exclusively. The Collor government, in privatizing fifteen companies, received assets of \$3.5 billion, but only \$16 million in cash.

The Itamar Franco government initiated the third phase of the PND by giving more emphasis to such factors as cash payments, fiscal considerations, and a broader distribution of share ownership. In order to expand and democratize the PND, the law was changed to permit: a) the wider use of Federal Treasury debts as privatization currency, b) the sale of the State's minority shares, and c) foreign purchase of up to 100% of a privatized company.

In 1994, the privatization program generated receipts of \$2 billion – 72% in cash – that were used to retire short-term public debt. It is worth noting that 89% of all the cash receipts from the privatization program were received in 1994.

The privatization of ESCELSA, the electricity distribution company in the State of Espírito Santo, in July, 1995, was a milestone of the resumption of the privatization program by the Cardoso Government. The sale of 50% of the company's shares capital yielded receipts of US\$ 387 million, 67% of which being cash payments. This first experience of privatizing a public service, involving a concession regime, will be followed by the privatization of LIGHT, another state electricity distribution company, scheduled to take place until the end of 1995. The fact that the PND has been modified to include the enterprises of the ELEKTROBRAS system (FURNAS, CHESF, ELETROSUL and ELETRONORTE) is a clear indication of the Government's interest in expanding the program.

PND Performance

Presidential Administration	Number of Companies Privatized	Amount Received in Cash Payment (\$ millions)	Sales Proceeds (\$ millions)
Collor 1990/92	15	16	3,494
Itamar 1992/94	18	1,581	5,113
Cardoso 1995	2	284	642
TOTAL	35	1,881	9,249

source: BNDES

The government received an amount of \$9,2 billion through the sale of public companies and stakes plus \$400 million through the sale of miscellaneous minority shares. Moreover, some \$3.6 billion of debt was transferred to the private sector. Nor can one forget the benefits from investments to be made by the new owners – in the steel sector alone, new investments through 1997 should total \$2.5 billion. Finally, one should note the privatizations' indirect benefits of increased tax receipts, improvements in the environment, creation of jobs and higher productivity.

The New Institutional Structure

The Brazilian Privatization Program (PND) is one of the Cardoso government's main reform instruments. Its priority status requires that it be highly agile and that its decisions be made at the highest levels of Government. Thus, the National Council for Privatization (CND) was created. It is comprised of cabinet-level officers, is chaired by the Minister of Planning and Budget and is directly accountable to the President.

This new structure enlarges the scope of, and gives more flexibility to, the PND without damaging its technical operations nor diminishing its transparency. The CND has been able of streamlining decision implementation because the members of the Council are officials responsible for the process within their own ministries.

CND Decisions

The importance that the Cardoso government places on privatization can be seen in the decisions made by the CND in its first meetings . They comprise:

- 1) full privatization of the petrochemical sector in 1995, including the privatization of Copene and 12 minority participations;
- 2) privatization of Escelsa, the Espírito Santo electricity distribution company. The auction took place in July, 1995;
- 3) privatization of Light, the Rio de Janeiro electricity distribution company, in 1995;
- 4) beginning of the privatization of financial institutions with "Banco Meridional ";
- 5) privatization of the cargo railway sector by having the Federal Railroad System (RFFSA) grant concessions for private-sector operation;
- 6) participation of foreign capital in the privatization of banks;
- 7) initiation of the process to privatize Cia. Vale do Rio Doce, included in the PND in June,1995..

The sale of the large electricity distribution companies – Light and Escelsa – and of the concession of cargo transportation services marks a new phase in the privatization program. This phase establishes the regulatory framework essential for the proper development of these activities. Ending its role as a producer, the government will not be neglecting its basic obligations, but rather will be focusing on its role as a regulator.

New Frontiers

The PND has been making an important contribution to the country since its creation in the early 1990s. In some cases, its actions have eased the pressures of the public debt, attenuating the

upward tendencies of interest rates. In others, it has promoted greater efficiency and competitiveness among private companies, having a direct effect on sectoral costs and on regional economies.

The privatization of public financing institutions constitutes one of the program's new frontiers. It should begin with the sale of the Meridional, a bank which operates principally in the south. Following the federal government's example, some states, such as Minas Gerais and Ceará, are working to privatize their financial sectors. Thus, the PND is creating an important precedent which other states could follow.

Having privatized the steel and fertilizer sectors, the PND will finish privatizing the petrochemical sector and proceed to overcome important infrastructure deficiencies, most notably in electrical energy, transportation and telecommunications. Brazil can no longer permit large shortfalls in infrastructure investments; it must look for partners in the private sector.

An inadequate infrastructure raises the costs of production, distribution and storage, placing national industries at a competitive disadvantage internationally. No private sector can be competitive without an efficient public sector. Thus, reducing Brazilian production costs requires improving infrastructure efficiency.

By transferring the operation of public services to the private sector, the State will be able to dedicate itself more adequately to the regulation and monitoring of these activities. This is essential for the country's economic and social development because only a solid regulatory mechanism guarantees the quality and continuity of public services. The privatization process is a basic instrument for moving Brazil toward a more prosperous and just society.

Concessions Law Creates Investment Opportunities

Brazil's development model during recent decades required the State to undertake major infrastructure investments. However, the budgetary crisis of the 1980's underlined the indispensable role

of private capital in financing national development. The new Concessions Law enables private sector investment to substitute for public sector investment.

Traditional privatizations signified the sale of a public asset. With concessions, the private sector will offer public services on behalf of the State, using assets that will revert to the public sector. This law will benefit directly the sectors of electricity, transportation, highway construction, ports and airports, basic sanitation, and water supply. Appropriate laws will be implemented to give investors stability and confidence. The State will by no means abandon its regulatory functions, functions that will require a reorganization and a re-equipping of responsible government agencies.



Annex

A Guide for Foreign Investors

Sales on the Stock Exchange

Up to now, Brazil's privatization program has been executed through the sale of the government's majority ownership in state enterprises, or the sale of minority shares in private enterprises. These transactions are made through auctions on the stock exchange, through public offerings, and through special sales to employees.

In these auctions, the shares are generally divided into lots of approximately \$500 each. Those participating in the auction can make their offers for one or more lots. As long as the number of lots requested is larger than the number offered, the auctioneer raises the price until demand equals supply. This system permits there to be more than one buyer per firm and gives each participant the chance to purchase exactly the number of shares desired. Participants in the auction must establish their identity and reliability before the auction takes place.

Limits on Foreign Participation

In general, foreigners can purchase 100% of a company being sold by the PND. However, a decree setting the terms of sale for a specific firm can impose a limit on foreign participation because of legal or other important considerations.

Proof of Financial Resources

For each auction, a maximum bid is established in Brazilian national currency for every participant in accordance with his demonstrated financial resources. The participant planning to bid can assign to the auction authorities the currency to be used in their privatization bids – including foreign debt instruments – or deposit a guarantee bond. He can then participate in the auction up to an amount equal to what he has assigned or deposited.

Privatization Currency

- The PND allows several types of currency to be used to purchase the shares of corporations being privatized. These currencies are:
- Brazilian currency (reais)
- agricultural debt instruments (TDA)
- obligations of the National Development Fund (OFND)
- Siderbrás debentures
- privatization certificates (CP)
- re-negotiated (securitized) debts
- foreign debt certificates and credits
- mortgages of the Caixa Econômica
- Federal Treasury notes

Participants in the auction must be aware that, in each privatization, a minimum percentage of the sales price must be paid in Brazilian currency (reais). The foreign investor can pay for the auction by using any of the currencies accepted in the privatization program. However, only foreign debt certificates and credits can be purchased outside of the country. The other currencies mentioned above are part of domestic debt and thus are negotiated on the local financial market.

Foreign Debt Certificates and Credits

The definition of foreign debt certificates and credits, as well as their use in the privatization program, is contained in Resolution No. 2062 dated April 12, 1994, of the National Monetary Council; in Decree No. 435 dated July 28, 1994, of the Ministry of Finance; and in Circular No. 2459 dated August 4, 1994, of the Central Bank.

Further inquiries about Brazil's privatization program can be addressed to:

Elena Landau

Director of Privatization and Infrastructure

BNDES

Avenida República do Chile, nº 100

Caixa Postal 1910

20001-970 - Rio de Janeiro, RJ

Brazil

Phone: (21) 277-6855 or

(21) 277-7589

Fax: (21) 533-1588

Fernando Perrone

Superintendent of Privatization

BNDES

Avenida República do Chile, nº 100

Caixa Postal 1910

20001-970 - Rio de Janeiro, RJ

Brazil

Phone: (21) 277-7212

AUGUST/95
CONSOLIDATED SALES ACCOUNTS

1991/95

SECTOR	COMPANY	% TOTAL EQUITY		PROCEEDS OF SALES	TRANSFERRED DEBT	TOTAL PROCEEDS	
		OFFERED	SOLD				
US\$ Million							
I. SALE OF STATE - OWNED COMPANIES AND RELEVANT STAKES							
STEEL	USIMINAS	85,1%	86,1%	1941,2	369,1	2310,3	
	CSN	90,8%	90,8%	1495,3	532,9	2028,2	
	ACOMINAS	99,9%	99,9%	598,5	121,9	720,4	
	ACESITA	74,0%	74,0%	465,4	232,2	697,6	
	COSIPA(*)	72,6%	72,6%	585,6	884,2	1469,8	
	CST	89,5%	89,5%	353,6	483,6	837,2	
	PIRATINI	72,5%	72,5%	106,7	2,4	109,1	
	COSINOR	99,8%	99,8%	15,0	0,0	15,0	
	TOTAL			5561,3	2626,3	8187,6	
PETROCHEMICAL	COPEPE (*)	11,8%	11,8%	253,8	342,6	596,4	
	COPELUL	82,1%	82,1%	861,5	9,2	870,7	
	PQU	58,9%	50,3%	287,5	40,9	328,4	
	PETROFLEX	100,0%	100,0%	234,1	20,7	254,8	
	POLIOLEFINAS	31,5%	31,5%	87,1	0,0	87,1	
	ALCALUS	100,0%	100,0%	81,4	5,7	87,1	
	PPH	19,0%	19,0%	59,4	35,0	94,4	
	POLISUL	31,0%	31,0%	56,8	131,0	187,8	
	OXITENO	15,2%	15,2%	53,9	2,0	55,9	
	POLITENO	24,9%	24,9%	44,9	28,4	73,3	
	NITRIFLEX	40,0%	40,0%	26,2	9,2	35,4	
	COPEERBO	23,0%	23,0%	25,9	5,8	31,7	
	CIQUINE	31,4%	31,4%	23,7	6,3	30,0	
	POLIALDEN	13,6%	13,6%	16,7	1,5	18,2	
	ACRINOR	17,7%	17,7%	12,1	0,7	12,8	
	CBE	23,0%	23,0%	10,9	0,0	10,9	
	TOTAL			2136,0	639,0	2775,0	
FERTILIZERS	ULTRAFÉRTIL	100,0%	100,0%	205,6	20,2	225,8	
	FOSFÉRTIL	88,3%	88,3%	182,0	44,0	226,0	
	GOIASFÉRTIL	100,0%	100,0%	13,1	9,3	22,4	
	ARAFÉRTIL	33,3%	33,3%	10,8	1,8	12,6	
	INDAG	35,0%	35,0%	6,8	0,0	6,8	
	TOTAL			418,2	75,3	493,5	
ELECTRICITY	ESCELSA (*)	50%	50%	385,7	2,0	387,7	
OTHERS	EMBRAR	50,5%	50,5%	192,1	263,4	455,5	
	CELMA	89,1%	89,1%	91,1	4,5	95,6	
	MAFERSA	100,0%	100,0%	48,8	0,5	49,3	
	SNBP(*)	100,0%	90,0%	12,0	0,0	12,0	
	CARAIBA	100,0%	100,0%	5,8	0,0	5,8	
	TOTAL			349,8	268,4	618,2	
TOTAL I				8851,1	3611,0	12462,2	
II. SALE OF MINORITY SHAREHOLDINGS (DECREE 1.068)							
ASSORTED	TOTAL II			395,5		395,5	
GRAND TOTAL (I + II)				9246,7	3611,0	12857,7	
				%	71,9%	28,1%	100,0%

(*) - NOT YET CONCLUDED

INSTITUTIONAL STRUCTURE OF THE PROGRAM

DECISION

PRESIDENT

NATIONAL COUNCIL FOR PRIVATIZATION

Minister of Planning and Budget (President of the Council)

Minister Head of the Civil Cabinet — Office of the President

Minister of Finance

Minister of Federal Administration and of the Reform of the State

Minister responsible for the company under privatization

President of the Central Bank (in the case of financial institutions)

SUPPORT AND MANAGEMENT

BNDES

NATIONAL BANK FOR SOCIAL AND ECONOMIC DEVELOPMENT

PRESIDÊNCIA DA REPÚBLICA
Secretaria de Comunicação Social
Subsecretaria de Imprensa e Divulgação

Apoio Institucional
Assessoria Especial da Presidência da República

Banco Nacional de Desenvolvimento Econômico e Social —
Diretoria de Desestatização e Infra-Estrutura

ESTA OBRA FOI FORMATADA
E IMPRESSA PELA
IMPrensa NACIONAL,
SIG, QUADRA 6, LOTE 800,
70604-900, BRASÍLIA, DF,
EM 1995, COM UMA TIRAGEM
DE 1.200 EXEMPLARES

