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**The Brazilian Government as a Shareholder
of Enterprises**

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1. Summary	3
2. The Redefinition of the Role of State in the Economy	4
2.1. Background	4
2.2. The Federal Privatization Program (PND)	6
3. The Federal Government Portfolio	8
3.1. The characteristics of the Federal Government Portfolio	9
3.2. The actors in the management of Federal Government Stock Portfolio	12
3.3. The management of Federal Government portfolio	15
4. The main difficulties and challenges in managing the Federal Government share portfolio	17
4.1. The Federal Budget Constraint	20
4.2. The minority shareholdings sale	22
4.2.1 National Privatization Fund (FND)	23
4.2.2 The Fund for Amortization of Federal Public Debt - FAD	24
4.2.3 Public Tender Offer (PTO)	26
5. Proposals to improve the shares management	27
5.1. Centralization of decisions about state owned enterprises	27
5.2. The selling of Federal Government minority shares	28
6. Conclusions	31
7. References	33

1. Summary

The main objective of this study is to present the role of the Brazilian Government as the shareholder of public and private enterprises, and the legal and operational difficulties in the management of these assets, as well as the challenges resulting from its interaction with the stock market as an owner and as a regulatory agent.¹

First, this paper will cover the Brazilian situation in the 1980s, when the economy faced a lack of resources for investments and had the external debt renegotiations as a big challenge in order to maintain its credibility abroad. This reality resulted in the end of the official financing model and subsidies for businesses and investors. As a direct result, Brazil applied a privatization model for public companies and services and opened the economy to foreign capital, which contributed to start the capital market development process.

Moreover, the paper will present the Federal Government portfolio, which includes its participation as a shareholder of public enterprises as well as its participation as a minority shareholder in private companies. At this point it will be important to describe the existing mechanisms for Federal Government sectors in the day-to-day management of these stocks and how they deal with the capital market.

Lastly, it will enumerate the difficulties facing Brazil in the management of these assets and will propose some changes as a solution to these problems as a way to ensure a higher level of efficient management.

¹ The views expressed in this work are those of the author and do not necessarily reflect institutional positions of the National Treasury Secretariat.

2. The Redefinition of the Role of State in the Economy

2.1. Background

After the great depression, it was clear that the market forces were not sufficient to achieve the necessary growth for that time in developing countries. The lack of capital market, the inflexibility of the labor market, the lack of enough private capital and the lack of high technology were some of the factors that prevented the players to generate an efficient outcome.

In this scenario, the state emerged as the only agent able to solve problems in the infrastructure sector, where the indivisibility and economies of scale require investment much higher than offered by private entrepreneurs. Only the state could invest in projects with low private returns and high social returns, assuming the risk of long-term high investments in a context of weak institutions and unstable laws.

Therefore the Brazilian state-owned enterprises were created as a function, primarily of the following factors:

- a) necessity to complement the development process with the establishment of heavy industry in the country, ensuring that local industry would not be limited to consumer goods, mainly because of the inability and / or disinterest of the private sector to invest in projects of long maturity and high costs;
- b) adoption of an import substitution policy;
- c) national security, because it meant that some areas should be reserved to the State to the security of the country;
- d) the nationalization of private enterprises in sectors with difficulty legislating without the control of property;
- e) the nationalization of private enterprises badly administered, in which the state had a social or strategic interest.

The nationalization policy was promoted by the use of available resources in the international market and started to be questioned even in the 1970's, when the interest rates raised and resulted in an increase of foreign debt cost and deterioration of the macroeconomic situation, leaving explicit the need to contain the economic growth rate. In this sense, a national program to reduce the bureaucracy and the State Enterprises Secretariat were created in 1979 and the Privatization Special Committee (CND) started the privatization process in Brazil in 1981.

Thus, the 1980s and 1990s witnessed a growing concern to redefine the role and limits of the State. The dominant liberal current tried to show that in most cases, the excessive concern with identifying the market failures hindered the perception that the state also was not ideal and that public companies did not have political autonomy and administrative capacity to implement correct decisions in time.

These companies were mostly characterized by low levels of productivity, distorted pricing and tariff structures, low investment capacity, low quality of goods and services produced, old technologies, and difficulty in negotiating wages because of the high level of its employee corporatism. This adds to the lack of medium and long term planning and the long time it takes to make decisions.

During the 1980s, the situation of state-owned enterprises has worsened because of scarce resources for investment and the increase of Brazil Cost due to cost inefficiencies of many services providers and industrial sectors that needed to be modernized. Meanwhile, economic globalization spread all around the world and Brazil was threatened by losing more and more space in the world economy, due to these inefficiencies.

So, the State that was seen as the solution became a point of much criticism, mainly on their administrative capacity. The bad operating results of these companies on one hand reflected wrong decisions on a technical level and loss of productivity and efficiency, while on the other hand, the difficulty in dealing with the multiplicity of objectives, which often conflicted.

In this context, privatization has emerged as part of a new development strategy, leading several countries to develop programs of privatization with the objective to increase efficiency and competitiveness of their economies, and to equilibrate public finances.

Strictly speaking, in its origin, the macroeconomic point of view, the main importance of privatization in Brazil was related to an intangible issue, that is, the recovery of the external image of the country, adversely affected by high inflation and the foreign debt crisis. Accordingly, the economy privatization was seen abroad as a demonstration of commitment of the country with the implementation of structural reforms that could open space for a new phase of development of the country. This positioned Brazil in line with the rhetoric of the "Washington Consensus" associated to reforms involving privatization, economy opening, fiscal adjustment, inflation control and, in general, the adoption of pro-market politics².

Thus, the 1980s was characterized by the reprivatization of companies that had been absorbed by the State, mainly as a result of their financial situation. At that time, the main objective was to prevent the expansion of the State presence in the economy so it privatized 38 small companies that resulted in revenue of only US\$ 780 million³.

But only in the 90s the country saw the foundation of a important privatization program, created by Fernando Collor de Mello, the president of Brazil at that time, with the publication of Law No. 8031 of 12.04.90, which established the Federal Privatization Program (PND).

2.2. The Federal Privatization Program (PND)

The PND, a main privatization instrument in Brazil, focused on the rationalization of public resources and modernization of the state. Without resources

² GIAMBIAGI, Fábio; ALÉM, A. CLÁUDIA. Finanças Públicas – Teoria e Prática no Brasil. 2.ed. Rio de Janeiro: Campus, 2000.

³ <http://www.bndes.gov.br/privatizacao/resultados/historico/history.asp>

to invest in public services that met a growing population, and more demands in terms of quality, the Brazilian Government decided to concentrate its activities in areas where the state should have a priority, like health and education, and allowed the private sector to take care of other areas. At the same time, the Federal State started acting as regulator and supervisor of services such as telecommunications and energy.

Moreover, the privatization process would also bring the following advantages:

- ? The federal government would be rid of the debt of some state enterprises, transferring it to private sector;
- ? The government would take profits by charging the income tax of those enterprises;
- ? Greater investment capacity and, as a result, more jobs being created.

The PND's main objective is the sale of state-owned industrial enterprises and the granting of public service concessions, and also the decisions about company closures when they have already fulfilled their role and do not interest private sectors. With the PND, the National Privatization Fund (FND) was created where the shares and stocks owned directly or indirectly by government are deposited, when the state-owned companies are included in the Federal Privatization Program.

As a result of PND many public enterprises were discontinued and some services provided by them were transferred to the Federal Public Administration and others were simply abolished.

Between 1991-1994 the federal government promoted the privatization of industrial enterprises and accepted many currencies as payments (Securitized Debt, Siderbrás Debentures, Privatization Certificates, National Development Fund Obligations, Agrarian Debt Securities and Caixa Econômica Federal Mortgage). Among the privatized companies the most important were: Companhia Siderúrgica

Nacional (CSN), Companhia Siderúrgica Paulista (COSIPA) and Aço Minas Gerais (Açominas).

The change of government representatives and the beginning of a new phase of the PND marked the following period of 1995-1998. During this time the transfer to the private sector of public services in the form of concession, lease or sale took place. Additionally the most important facts were the electricity sector privatization, the leasing of regions of Brazilian Federal Railways (RFFSA), and the privatization of Companhia Vale do Rio Doce SA (CVRD) and Telebras System.

The higher revenue since the beginning of the program, in the amount of US\$ 7.7 billion distinguished the year 2000. This was when happened the first global tender offer of Petroleo Brasileiro S.A(Petrobras) preferred shares. These shares, which exceeded in number the quantity necessary for the federal government to maintain stockholding control of Petrobras, were sold. The offering that was held in Brazil was innovative in the sense that it allowed employees to use part of their funds at the Workers' Time of Service Guarantee Fund (FGTS) to pay for these shares. The currency volume mobilized through FGTS was significant, reaching US\$ 898 million, corresponding to 312,194 employee's accounts. The total operation represented US\$ 4.0 billion. In November, the Spanish Bank Santander bought the stockholding control of Banco do Estado de São Paulo (BANESPA) for US\$ 3.6 billion.

In respect to state-owned enterprises, Brazil Government privatized state banks that were federalized as payment of the states debt from the Brazilian Government in recent years The Goiás State Bank (BEG), the Amazonas State Bank (BEA), the Ceará State Bank (BEC) Bank and the Maranhão State Bank (BEM) were sold.

3. The Federal Government Portfolio

After the privatization and liquidation of companies occurred in previous decades the Brazilian Government began to focus its activities in strategic sectors as

a result of social and economic issues. In November 2008, the Federal Government portfolio had itself composed of 127 companies: 21 were public companies, in another 25 companies the government was the majority shareholder and in 81 it was the minority shareholder. The Government has also participation in Alcântara Cyclone Space, a bi-national company⁴.

Using the weighted average value of shares listed on stock exchange in October 2008 and the representative value of the government participation in this capital, the value of portfolio is approximately US\$ 85.7 billion⁵. Even though 99.2% of these totals are centralized in state-owned enterprises it is important to note the number of minority shareholding in the current government portfolio although the value of them is not representative. This reality has created an additional administration cost and the process of alienation of these assets is facing some legal and regulatory barriers that will be discussed in the next chapter.

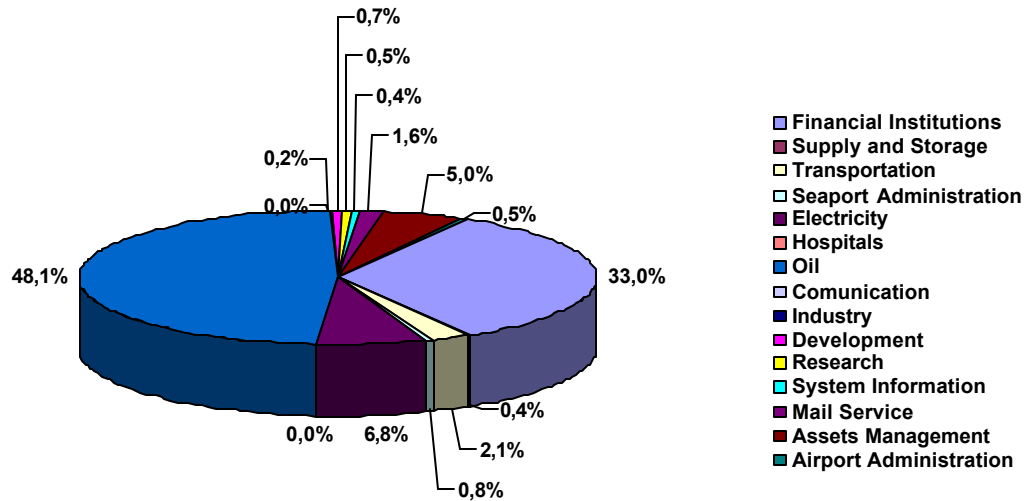
3.1. The characteristics of the Federal Government Portfolio

Analyzing the companies that took part in the Federal Government Portfolio in the end of the year 2008, it is observed that, from the total value of US\$ 85,1 billion represented by government controlled companies, 48.1% is in the oil sector, represented by the government shares in the Petróleo Brasileiro SA - PETROBRAS, followed by financial institutions, with 33.0% consisting of six banks in which two are public banks and four under government stockholding control.

⁴The National Treasury Secretariat – STN/COREF/GECON

⁵The National Treasury Secretariat – STN/COREF/GECON
Converted in the exchange rate of 10-30-2008.

Participation of the Brazilian Government by Economic Sector



The participation of the Brazilian government in state-owned enterprises has not change significantly in the last five years, which shows the reduced performance of the Federal Government in the capital market and the focus of investment in strategic sectors and where there is social interest, as noted in the following table:

Table X- Participation of the Federal Government in Enterprises

FEDERAL GOVERNMENT PORTIFOLIO	2004	2005	2006	2007	2008
Public Companies	22	23	22	23	21
Shareholding control	30	29	29	27	25
Sub-total	52	52	51	50	46
Minority shareholding	48	54	72	83	80
TOTAL	100	106	123	133	126

Source: National Treasury Secretariat

In 2005, due to the Brazilian energy crisis, was created the Energy Research Company, a public company, with the aim to provide services in the area of studies and research needed to support the planning of the energy sector, such as electricity, oil and natural gas and its derivatives, coal, renewable energy sources and energy efficiency, among others.

The Ceará State Bank (BEC) was also privatized by the amount of US\$ 302.1 million⁶. Those shares had been transferred in the past to the Federal Government as part of the payment of the Ceará debt under the Law No. 9496.

The portfolio did not significantly change between 2005 and 2006. The Emergency Electricity Brazilian Trader – CBEE ceased its activities in 2006 as defined in its creation law. The company objective was the acquisition, leasing and sale of goods and rights, the contracts assignment and other decisions as a way to increase generation capacity and supply of electric energy from any source in the short term and to overcome the energy crisis and reach the equilibrium between supply and demand of electricity.

In 2007, the government ceased the activities of the Central Supply of Amazonas SA (CEASA-AM) and the Federal Railroad Network (RFFSA). In the same year, a public broadcast company, Brazilian Communications Company (EBC), was created. Its main objective is to increase the supply of telecommunications options for programs and also have a greater direct influence in the civil society.

During 2008 the main changes in the Brazilian Government portfolio was the extinction of Empresa Brasileira de Planejamento de Transporte (GEIPOT), and the merging of Empresa Brasileira de Comunicação SA (Radiobrás) with EBC and the Santa Catarina State Bank (BESC) and BESC Credit SA (BESCRI) with Bank of Brazil.

Thus, after the privatization period, the years that followed were characterized by the continuation of government participation in sectors previously defined as strategic.

However, it is important to note, the growth in the number of companies where the Federal Government works as a minority shareholder from 48 companies in 2004 to 80 in 2008. There are two main reasons that justify this increase. The first refers to

⁶ Secretariat of National Treasury – STN/COREF/GECON
Converted in the exchange rate of 12-21-2005.

the centralization of shares that were registered in different sectors of the Brazilian Government as legislative, executive and judiciary powers, in order to unify the monitoring and increase the efficiency in the administration of these shares by Ministry of Finance. The other reason was the transfer to the Central Government as a successor in ownership of shares of extinct companies such as the National Highway Department (DNER) and the Superintendência de Desenvolvimento do Nordeste (SUDENE).

From all companies where Central Government has shares 56 enterprises are listed on the Stock Exchange of São Paulo (BOVESPA), but 49 are minority and only 7 are state owned enterprises. Regarding the special listing segments of the Bovespa, only the Brazil Bank is in the New Market and Brazil's Federal Power Holding Company (ELETROBRÁS) is at Level I of Corporate Governance.

Some companies even issue certificates of stock to its shareholders, with their record in a specific registration book that stays in the companies' documents. Considering that the article 119 of Decree No. 93872 of 1986 defined the Central Bank of Brazil to guard these values, the certificates are sent to the bank's custody. However, as established by article 34 of Law No. 6404 of 1976, the majority of companies maintain their shares in system form, registered in deposit accounts in financial institutions without a certificate emission.

In this way, the Brazilian Government shares are guarded by various financial institutions resulting in regular contacts with various departments of shareholders. In minority companies, because of the irrelevant participation value, often the Federal Government is classified by these banks with the others shareholders, which sometimes distances the relationship with the agents of the stock market.

3.2. The actors in the management of Federal Government Stock Portfolio

Unlike the private sector, the Ministry of Finance interacts with other federal agencies in managing their assets. Thus, the shareholder administration is exercised in a shared manner. The main actors in their performance are: the National Treasury

Secretariat attached to the Ministry of Finance, the State Owned Enterprises Coordination and Control Department (DEST), the Federal Budget Secretariat (SOF), both of the Ministry of Planning as well as each company Supervisor Ministry and the Federal Revenue Attorney General's Office (PGFN).

As defined in Decree No. 93872 of 1986, it is the National Treasury Secretariat's responsibility to manage the Federal Government's shares from state-owned enterprises until shares where the Federal Government acts as a minority shareholder.

The Administrative Rule No 141 of 2008, established that it the responsibility of the National Treasury Secretariat to be the administrator of their moveable assets. The article No 44 defines that it is a task of Financial Liabilities and Secured Assets Department among others:

- ? Manage the shares of the Federal Government, and their incomes and rights;
- ? Undertake the indication of the National Treasury representatives in the supervisory boards of companies;
- ? Assisting the Federal Revenue Attorney General's Office in preparing the vote as the representative of Brazil Government in the entity meetings in which the National Treasury participates;
- ? Evaluate the profit proposed allocation of public and indirectly controlled enterprises by the Government;
- ? Decide about exchange transactions, subscription and purchase and public trade offers, especially about the opportunity and convenience of these operations, as well as the price and form of payment;
- ? Analyze about shareholders agreement and right waiver by the company directly or indirectly controlled by the Government and in respect of any acts for which the National Treasury needs to be heard;
- ? Analyze the financial statements of companies controlled directly by the Federal Government and propose, when appropriate, measures that influence positively its outcome or remedies that can even result in their privatization.

Besides the Ministry of Finance, the Ministry of Planning also has responsibilities related to state-owned enterprises. The DEST that has the task of improving the State function as shareholder of state-owned enterprises is responsible for elaborating the Global Expenditure Program (PDG) and the Budget Investment (OI) in companies that the Federal Government holds, directly or indirectly, a majority of vote shares.

The Department also monitors and provides economic and financial information about state-owned enterprises, and is involved in wage policy, approval and possible changes in pension schemes of these companies, council indication and its number of employees.

Minority shares are not included in the universe of companies accompanied by DEST. In addition, that Department monitors the subsidiaries (Federal indirect participations) of the Eletrobras, Petrobras and Banco do Brasil.

Those companies in which the spending budget and also the Investment Budget are integrated into the Federal Fiscal Budget are defined in the Law of Fiscal Responsibility as "Dependent Corporations" and are monitored by the Federal Budget Secretariat (SOF).

Regarding the legal representation of the Federal Government, the Procedure Rules of the Federal Revenue Attorney General's Office (PGFN) states in article 1 that they have the authority of representing and defending the Government interests in the companies assembly, as well as in acts of subscription, purchase, sale or transfer of shares or right to subscribe. The rules also provide the articulation with the National Treasury Secretariat and DEST on matters to be discussed in shareholders assemblies to issue an opinion that supports the decision of the Minister of Finance.

In addition to the agencies described above, there are regulatory bodies such as the Central Bank that standardize questions related to financial institutions and the Securities and Exchange Commission of Brazil (CVM) that has the function of

discipline, standardize and supervise the activities of several members of the market values securities.

It is clear that the management of the government shares by the Treasury Department require a constant partnership with other regulators agent which makes the process safer and more transparent as a result of regulatory and supervisory powers of other agents. However, this governmental structure in some situations makes the decision of the government slower. As a result, one of the most challenging questions is: How to make the information flow faster and in a secure way to meet the time demands, seeking to optimize available resources and reduce the costs of the proceedings?

3.3. The management of Federal Government portfolio

The monitoring and controlling of government shares are made through the database from which the information necessary to make decision is extracted by the Ministry of Finance.

In respect to state-owned enterprises, the management is done directly since as a controlling shareholder, the government has representation on the Board and also on the Fiscal Council of these companies and all corporate materials are sent for analysis and opinion.

In accordance with article 132 of Law No. 6404 of 1976, the general shareholders meeting must occurs by 30 April of each year after the end of the fiscal year for:

- I - to approve the financial statements;
- II - decide on the allocation of net income and distribution of dividends;
- III - elect the directors and Fiscal Council members.

By the time of a shareholders meeting, the STN receives the material for analysis and opinion. After this stage, the subject goes to the PGFN for analysis of

the legal aspects and to elaborate the Minister of Finance vote whom they represent in the meeting

In addition to the matters treated by the Ordinary General Assemblies, the shareholder also votes on other issues, such as:

- ? Reform of social rules;
- ? Modification of the capital;
- ? Capital opening or closing;
- ? Authorization for debentures issue;
- ? Merger and division of the company,
- ? Company dissolution and liquidation.

In respect to the minority companies in which the Government has no representation on the Fiscal Council, although the value in these businesses is not representative, the high number of companies often results in different requirements for analysis by the Government. Different from the state-owned enterprises, in those companies the main topics on which the Government as a minority shareholder always point out their position is: subscription bonus exercise and its participation on public tender offers.

To track the changes in the companies and in its portfolio, the STN works with the state-owned enterprises, in the case of companies not listed on the BOVESPA and with the banks custodians in the case of companies that do not produce share certificates. In this case, the bulletins stock and newsletters, and other relevant facts addressed to the stock market are received periodically.

After all management registers, the changes in the Government portfolio are registered as investment in the Integrated System of Federal Government Financial Administration (SIAFI).

4. The main difficulties and challenges in managing the Federal Government share portfolio

The purpose of this section is to point out some practical problems found in managing these assets and in the next chapter proposes some actions to minimize these problems. At this time, however, it is important to point out some ideas in the literature about the role of government as an owner of enterprises and the efficiency of these companies in respect to the reality of private companies.

A major justification for the privatization process is to promote the increase in enterprise efficiency in the systemic and microeconomic levels.

In the systemic level, the idea that results in the increase of efficiency is based on the assertion that the government's budgetary constraints do not allow the efficiency of business activities. Thus, the transfer of business to the private sector would result in the expansion of its productive capacity, technology investment and the increase in competition that would result in the increase of the companies' efficiency. The increase in investment and the solution of problems in key sectors of infrastructure would result in gains for the whole economy.

In addition to increased efficiency at a macro level as a result of a high competition, the increase of investment and absence of the State would result in an increase in the private efficiency at the microeconomic level as a result of objectives clarity, improved supervision of the managers about the employees and vice versa and greater market discipline.

In fact, public companies have one private and one public side. On one hand have commercial purpose, related to production and marketing of goods or services looking for profit on the other hand are the objectives of social and economic policy such as the development of important sectors, the integration of national territory and concern with social order searching for the common interest.

These public and private sides have a negative impact on economic efficiency, because the managers do not always have clarity of objectives of the

controlling shareholder. This situation makes it more difficult to make decisions and to allocate resources and, also, the social objectives are usually achieved with the sacrifice of business profitability objectives. This reality contrasts with the situation in the private sector, where business is guided by the goal of maximum profit with a minimum cost possible.

However, it is important to realize that the profitability variable should be used with caution in regard to assessing the efficiency of state-owned enterprises. It's difficult to obtain an appropriate measure of comparison for the performance of public enterprises. They often operate as monopolies in their sectors and the existence of different social objectives hinder the empirical evaluation of the state-owned enterprises efficiency compared to what would be in private entrepreneurs' hands⁷.

Another important aspect that differentiates a state company from a private is the degree of access to Federal resources. This allows the company to sustain major and systematic loss without being obligated to leave its activities as a result of government social choice function.

The company's performance evaluation, before and after privatization, is also difficult to measure. The privatization process occurs in the midst of other structural reforms such as the change in the company's objectives making it impossible to compare the two moments and reach definitive conclusions.

However, experience⁸ shows that some stylized facts can be identified:

- a) historically, the state owned companies had lower returns on equity to private enterprises;
- b) on average, they work with higher ratio capital-output than private companies;

⁷ Além e Giambiagi

⁸ PINHEIRO, Armando; GIAMBIAGI, Fábio. *As Empresas Estatais e o Programa de Privatização do Governo Collor*.

- c) these companies often have excessive number of employees in management services;
- d) the competition is more important to explain the difference in performance between state and private enterprises than the ownership of the capital, since in competitive sectors the private companies are generally more efficient than the state owned enterprises, without significant differences between them in oligopoly sectors;
- e) When the privatization process begins, the company is prepared to be sold. As a result productivity and profitability are increased before the actual transfer to the private sector.

This data suggests that the ownership of capital is a secondary impact on the companies' performance. It is most affected by the presence of competitors, the clarity of its objectives and the presence of an active and transparent government.

According to Pinheiro⁹, several authors tried to compare the relative efficiency of private and state-owned enterprises. These studies, when analyzed together, did not lead to a conclusion on this issue.

Meggison¹⁰ also published research that compared the performance of 61 companies in 18 countries and 32 industries privatized between 1961 and 1990. The results showed strong evidence in favor of privatization, because there was an increase in profitability, sales, investment, operational efficiency and the number of employees. Furthermore, privatization decreased the level of indebtedness and increased the dividends payment.

Another interesting study was done by Lima¹¹, who after examining the case of ten Brazilian companies suggests that the change in ownership structure, in fact,

⁹ PINHEIRO, Armando Castelar. *Op cit.*

¹⁰ MEGGINSON, W.L.; NASH, R.C. e RANDENBORGH, M. VAN MEGGINSON *et alli. The financial and operating performance of newly privatized firms: an international empirical analysis. Journal of Finance.* Apud: LIMA, Edilberto, Carlos Pontes, p. 403-52.

¹¹ LIMA, E.C. *Privatização e Desempenho Econômico: Teoria e Evidência Empírica.*

has an important role in improving the economic performance of companies. However, when the company operates in an uncompetitive market structure, the conclusion that the private sector is more efficient is more difficult to be achieved.

4.1. The Federal Budget Constraint

Undoubtedly, the government's budget constrains must, in many situations; result in the deceleration of the investment level. This contributes to the fact that the functioning of the state owned enterprises is subject to financial and production governmental systems within big social objectives.

In Brazil, the big challenge is to manage the different aspirations of the various components of the federal budget into a budget that is always less than the sum of the demands of the various organs which compose it.

This fact is clearly seen in the preparation of the Investment Budget of the State owned Enterprises. In accordance with article 165 of the Federal Constitution, the companies in which the Federal Government has, directly or indirectly, the majority of its assets need to have their investment budget subject to the approval of the National Congress. Moreover, these investments need to be subject to the provisions and priorities established in the Budget Guidelines Law - LDO.

Another important aspect is the participation of these companies in achieving the primary surplus, which helps the central government to meet its pre-established goals. In 2007, the generation of the primary surplus by state owned enterprises reached R\$ 16.3 billion, equivalent to 0.64% of Gross Domestic Product – GDP¹².

For budget monitoring, the state owned enterprises are divided into two major groups:

- I - companies which pay its activities with own or market resources, and

¹² Anual Report.DEST - 2007

II - companies that depend on resources from the fiscal budget to pay part or all of its current expenditure, known as "Dependent Corporations"

The first group of enterprises is directly accompanied by DEST and has its budget for each year registered in the Global Expenditures Program - PDG.

The PDG is based on the proposals submitted by the companies. During the budget elaboration process the macroeconomic parameters developed by the Federal Government are used and make the statistics compatible with the fiscal surplus goals .

The table below has the historic investment amount of the companies that are in the PDG. The Petrobrás group has the biggest amount of investments and it has been increasing each year. The source most used for financing has been its own resources followed by long-term loan resources.

US\$ million

GROUPS	INVESTMENTS								
	2003	2004/2003	2004	2005/2004	2005	2006/2005	2006	2007/2006	2007
I - State Productive Sector	8.725	14,5	9.993	14,9	11.484	18,4	13.602	21,6	16.545
PETROBRÁS Group	7.244	18,3	8.570	14,1	9.779	20,3	11.769	25,6	14.777
ELETROBRÁS Group	1.255	-2,9	1.219	12,6	1.373	-0,1	1.371	-3,1	1.328
Others	226	-9,8	204	62,5	332	39,2	462	-4,8	440
II - Financial Institutions	584	3,3	603	-9,6	545	-18,7	443	7,5	477
TOTAL	9.309	13,8	10.596	13,5	12.029	16,8	14.045	21,2	17.022

Source: DEST

The second group, composed of 16 companies has their expenditure budget, including investments, integrated into the Fiscal and Social Security Budget. To avoid duplication in monitoring these companies, their control is carried out by the Federal Budget Secretariat.

Another important aspect is the tradeoff between the ratio of profit that will be reinvested or distributed to the shareholders. The main result has been many enterprise managers searching for results and the elevation of the efficiency level, including programs for spending efficiency.

4.2. The minority shareholdings sale

Although the Federal Government participation in companies as a minority shareholder presents, in recent years, a trend of growth, this is not typically a state function.

Furthermore, the management of these stocks results in administrative costs to the federal government, requiring the accompaniment of information representative of small values.

As observed in the previous chapter, the increasing participation of government as a minority shareholder is principally a result of the transfer of shares held by extinguished companies and the unification of the stocks' records were spread in different federal government agencies.

Decree No 1312 of 1994 establish that the recourses resulting from federal government share sale should only be used for repayment of federal debt which further reinforces the necessity of selling these assets .

So the question that presents itself is: Why are these shares not sold?

Before evaluating the best sale model for these shares, it is necessary to consider the portfolio characteristics. From a total of 80 companies, only 49 are in the stock market. This reality makes the negotiation of such actions difficult. Many infrastructure state companies have large debts and do not operate in the stock market.

In November 2008, the value of this portfolio was about US\$ 662 million¹³ of which US\$ 455 million was represented by stock market companies. Also 88.3% of this value was represented by only 3 more expressive companies, which shows the residual value of other firms.

¹³ National Treasury Secretariat
Converted in the exchange rate of 10-30-2008.

Nowadays there are two ways provided by law for the Federal Government to sell minority shares: the Fund for amortization of Federal Public Debt (FAD) and the Federal Privatization Program (PND).

The Federal Government has also been reducing the amount of minority shares by accepting Shares Buyer Offers, in which the company controlling shareholder go to the stock market and announce that they are willing to buy the remaining shares of individual shareholders and the conditions of such purchase.

However, as described below, all three ways face operational or legal barriers that have hindered the sale of this portfolio.

4.2.1 National Privatization Fund (FND)

As described in Chapter II, the National Privatization Fund (FND) was established under the Federal Privatization Program (PND) for the share deposit of companies included in the PND that were in the process of privatization or extinction. However, although it was not created for the purpose of having Federal minority stocks, there is a legal authorization for sale of these shares through FND in article 2 of Law No 9491.

The decision structure of PND, represented by the National Privatization Council - CND, composed of Federal ministers subordinated directly to the President of the Republic, shows the purpose that justified its creation and the relevance of subjects to be addressed in that forum. Thus, the need for approval of important government representatives, in the case of minority shares, would generate increase in the indirect management cost

In addition there is a political issue. On one side, there are those who believe that PND was a positive mark of Brazil history. On the other side, there are those who think that the Government should have a strong participation in the economy

and they see the Program as a big mistake. Thus, the success of the PND would be vulnerable to the government of each time.

The Decree No 2594 of 1998 specifies the procedures for evaluation and sale of those shares, which includes, among others, the elaboration of studies to define the minimum price of the shares and publication of notice. However, to facilitate the sale of government minority shares, the Article 33 of that law defines that the CND can establish simplified procedures in these cases, which includes the determination of minimum price.

As a conclusion, even though the PND is allowed to sell the Federal Government shares, this process has not been used.

4.2.2 The Fund for Amortization of Federal Public Debt - FAD

In 1994, the Federal Law No. 9069 created the Fund for Amortization of Federal Public Debt (FAD). The main objective of its creation was boosting the sale of the Federal Government minority shares and also creates additional resource for the reduction of public debt.

That period was very important in Brazilian history and was characterized by the creation of the Real Plan and the necessity of better fiscal results was an essential condition for the success of combating inflation. In this context, the Brazilian Development Bank (BNDES) became the FAD manager because of its experience in the stock market as a manager of FND and because it has been an institution executing public policies.

The first problem in dealing with FAD was the lack of definition about the shares' selling price.

First the FAD had only shares of the companies listed in BOVESPA. The law that established the FAD allowed BNDES to adopt the measures necessary for the sale of such stock. It also specified that the percentage of shares and the sale orders

would be result of a decision between the Finance and Planning Ministers. They would define the number, type and class of shares, as well as criteria for fixing the price, taking into account the values of these assets in the stock market.

However, the legislation was amended to allow also the deposit of shares of companies that did not negotiate in the stock market. The problem, however, was that these changes were not followed by the new criteria for the sale of these shares.

Thus, the existence of legal requirements, such as the edition of the amended to include these shares in the FAD, and the lack of specific rules about the sale process resulted in a non achievement of the Fund original expectations.

As a result, the stocks were sold to BNDESPAR Participation, using the conditions contained in Decree-Law 2383/1987, which allowed the authorities of the Federal Administration Indirect to acquire shares and other securities based on the average price value of the previous week in case of listed companies, and the value of the last balance sheet for the other ones .

Under these conditions some contracts have been signed with BNDESPAR, in the total amount of US\$ 44.3 million. The not publicly-traded shares remained in the FAD portfolio. In those contracts there was a prediction for the transfer of any difference between the initial value based on the VAP and the final value of sale established by BNDESPAR.

In 2002, as a result of the necessity of FAD flexibility a bill was sent to Congress. The main purpose of that bill was to authorize the BNDES to act in the Federal Government name and practice all acts necessary for the sale of those stock in the market, including the definition of the share minimum price. However the bill remains in the Congress waiting for approval.

Due to the inexpressive results of FAD, the federal government stopped using the fund to sell their shares and is looking for new alternatives to promote the sale of its minority shareholdings.

4.2.3 Public Tender Offer (PTO)

The tender offer is a public, open offer (usually announced in a newspaper advertisement) by an acquirer to all stockholders of a publicly traded corporation to tender their stock for sale at a specified price during a specified time, subject to the tendering of a minimum and maximum number of shares. In tender offers, the bidder contacts shareholders directly, inviting them to sell their shares at an offer price. The directors of the company may or may not have endorsed the tender offer proposal.

There are currently, in Brazil, six kinds of Public Tender Offers¹⁴:

- I - PTO for registry cancellation: it is a mandatory tender offer, held as a condition of the company registration cancellation, under art. 4 of Law 6404/76 and art. 21 of Law 6385/76;
- II - PTO to increase participation share: the PTO is required as a consequence of the controlling shareholder participation increase Law 6404/76;
- III - PTO as a result of changing control: the mandatory tender offer is held as a condition of legal validity of the company control transfer;
- IV - Voluntary PTO: the acquisition of company shares that should not take place according to specific procedures established above;
- V - PTO for the acquisition of company control;
- VI - Competition PTO: bid made by a third party who is not the offer and has as an object, shares that are in a tender offer process.

Even though the tender offer is a buyer initiative, this instrument has resulted in the sale of some Government shares.

Among the general procedures of a tender offer there is the need of a financial or security institution to intermediate the process.

This is the main difficulty of the Brazilian Government in doing these operations. Unlike the private sector, to contract such services, it is necessary to

¹⁴ Instrução CVM n361, de 5.3.2002.

have a bidding process. Even in cases of service in amounts below the one established in the law of tenders and contracts (R\$ 8.0 thousand), it is necessary to elaborate the dispensation process and the contractual instrument summary publication in the official press.

The time for acceptance of a public tender offer is about thirty to forty days after the announcement. The problem is that in some cases this period is not enough for all procedures that need to be adopted by the Government. The main actions go through the analysis of convenience and opportunity to join the PTO until the order of the Minister of Finance authorizes the operation. It is interesting to note that the process is too long and sometimes the value is not so relevant.

The conclusion is that these ways require a complex process and it is necessary to create ways to make the process more simple and efficient.

5. Proposals to improve the shares management

There is no doubt about the progress that happened in the Federal Government stock management. The centralization of all these data in the National Treasury Secretariat allowed increasing the Government portfolio.

It is a process that has been improved during the years and with this purpose, some practical actions are suggested to improve this management even more.

5.1. Centralization of decisions about state owned enterprises

Regarding the budget restriction imposed to the state-owned enterprises, it is easy to see that the most appropriate way to minimize the issue is to improve even more the definition of government goals with the increasingly active participation of state-owned enterprises.

So, the government may maintain its role as shareholder in order to define coordinated policy for state enterprises within the concepts of management and ownership.

Currently, the main movement to greater transparency and the state owned enterprise planning has been studied in the corporate governance matters .

Although corporate governance is not the main issue of this paper, it is important to say that the applicability of the corporate governance principles has as its main objectives: a) more clarity and consistency of government policies, b) increase in the state-owned enterprises efficiency, c) increase the managers' knowledge, d) increase transparency of financial statements and e) respect the minority shareholders rights.

As observed in Chapter III, there are several federal institutions involved in defining and monitoring the strategy of state-owned enterprises. Aiming to improve the coordination of the Brazilian government in performing its role as a shareholder, the Commission for Corporate Governance and management of Federal Government shares (CGPAR) was created in January 2007.

The main purpose of this committee is to establish clear policies and strategies for the state owned enterprises , ensuring the adoption of governance practices that result in an increase in efficiency, transparency, and respect the rights of other shareholders.

The centralization of decisions will enable better identification of the shareholders strategies, resulting in a better planning in medium and long run and to the economic and financial equilibrium of these companies .

5.2. The selling of Federal Government minority shares.

The proposal here is not to determine the best way to sell the minority shares of the federal government but rather list some suggestions that can be adopted to facilitate the process of administration and sale of those assets.

First, there is no doubt that the dispersion of these assets in many financial institutions makes the process of getting information and taking decisions slower. So, the first proposal presented here is the unification of the official custodian of the Government minority shares registered in different financial agents. It will also make the relation between the institution and the government easier.

Thus, maintaining the data in a single bank the selling process will gain agility and the number of shares will decrease more quickly.

The choice of the official custodian and contract form should be analyzed by the STN and the PGFN to set the best instrument to be used in this process.

The CVM Instruction No. 286 of 7.31.1998, established rules for the selling of shares owned by the government. The objective is to protect public access to information about the securities traded as well as the care of the legal principles of public morality and full transparency.

The federal government minority shares must be sold through special auctions in the stock exchange or in the organized market. The conditions of sale must be announced to the market at least 2 working days before the date of the auction.

The sale of non listed company shares also needs to have the announcement previously approved by the CVM and special auction on the stock exchange or in the organized market.

So, the main issue becomes the definition of the instrument that may be used to promote the sale of these shares.

The Decree No 1068 of 3.2.1994 determines that the minority shares held by public companies or any other entities controlled, directly or indirectly by the Federal Government, shall be deposited in the PND. After the deposit by the holders of these assets, the BNDES, as the manager of the FND, conducts an auction on the stock exchange market and transfer the ownership of these stocks .

Thus, considering all the difficulties already mentioned about the sale of Government minority share and the BNDES knowledge due to PND management, an alternative would be to hold the minority shares in the PND.

The use of the auctions structures conducted by BNDES would also result in cost minimization to the Government and would increase transparency. For example, the cost of choosing the financial institution to promote the auction would not exist. Also, the article 27 of Decree No. 2594 of 1998 provides that in case of minority share sale with small value, the BNDES can exempt the government from the remuneration and reimbursement of the process expenses.

In accordance with Article 33 of Decree, the CND may establish simplified procedures for the minority shareholding sale. Thus it is necessary to create rules for CND that define the sale conditions which includes since the auction form until the minimum price definition.

The process would consist of 9 main steps below:

- ? Publishing of CND's normative regulation of the Federal Government minority share sale;
- ? Analysis of shares to be deposited in PND by the National Treasury Secretariat;
- ? Elaboration of expenditure budget by the National Treasury Secretariat;
- ? CND resolution with recommendation and approval of the shares to be included in FND;
- ? Deposit of shares in FND / CBLC by the National Treasury;
- ? Analysis of the sale conditions by BNDES Capital Market Department;

- ? Publication of announcement by the FND manager;
- ? Physical stock transfer (D +2);
- ? Financial resources transfer (D + 3);
- ? Payment of remuneration to the manager if applicable.

The shares deposited in FND would be subject to the CND rules and decisions. Considering that the tender offers have different criteria from the FND the government could not use those offers to sell their assets.

Considering that the PND Decree defines that the CND can establish simplified procedures for the minority government shares sale, the best solution is for the CND to establish the criteria defining a general process in which the shares in PND can be sold through tender offers. This process need to be timely in order to meet the deadlines stipulated by the PTO.

However, once in operation the process of selling through auctions, the participation of the government in tender offers will be rare.

Another suggestion is that the Minister of Finance expedites an authorization that allows the National Treasury to sell the minority shares through tender offers when the total amount of the process does not exceed a value set internally. It simplifies the process and avoids that the Minister of Finance has to discuss and assign questions of such value.

In respect to FAD, its history of failures linked to the absence of definitions in the sales operation and the existence of FND that meets the functions performed by that Fund, suggests the FAD should be abolished.

6. Conclusions

The Brazilian Government has advanced in recent years following the global trend of market opening and redefining the state role in the economy.

Regarding the past, the privatization model redesigned the federal government portfolio composition and improved the state enterprises management. Today, the Brazilian Government's participation is concentrated in the oil, energy and financial institutions sectors.

The development of fast and innovative capital market has required from government the study of new practices and the review of processes established in the past. In this sense, the work highlighted the main challenges the current management has. These include the restriction imposed on the state budget and the decentralization of decision making as well as the necessity of new forms of alienation of minority government shares.

Currently the government has sought through the principles of corporate governance, disseminated in the OECD arena, the optimization of these assets management. One important step is the unification of the decision process with the CGPAR creation.

After analyzing the current models available to reduce the number of government minority shares, this paper concludes that The Federal Privatization Program (PND) is the best way to achieve this purpose. It will require some government adjustments in order to facilitate the implementation of the auctions. However, the benefits of this decision undoubtedly outweigh the cost of managing these assets.

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