

Privatization: myths and false perceptions

Licínio Velasco Jr.*

* Head of the BNDES Privatization Services Department

Abstract

This article discusses the privatizations which have taken place in Brazil from the point of view of implementation of public policy, with a view to throwing light on questions which lead to decisions in Brazilian public policy. The reader is taken through the various stages of decisions by the Brazilian public administration structure, providing a dimension less frequently found in analyses of the subject. There is also a brief discussion of the type of conflicts which may be expected in the period subsequent to privatization of public services.

1. Introduction

Now that almost two decades have passed since privatizations began to become a more or less frequent element in Brazilian public life, much has been written on the subject. In general these works have focused on the financial and economic effects of the privatizations, including their contribution to reduction of the public debt, modernization of Brazil's industry, and redefinition of the role of the State. However, there has been little discussion on the *practices* of privatization. More specifically, little has been asked about how privatizations happen and why they are implemented in one form rather than another.

This paper discusses some of these questions, based on the privatizations implemented in Brazil since 1985, in the Sarney, Collor and Itamar Franco governments and the first Cardoso government. We do not aim to evaluate privatizations in the light of these questions, but to provide some alternative views to current perceptions which are judged to be inappropriate. For the purposes of organization of the material, these perceptions will be considered as "myths" or "false perceptions", so that they can be discussed and evaluated¹.

Section 2 discusses the reasons for the privatizations of the Sarney period. The conclusion reached is that in this period internal motivations of the BNDES prevailed over external reasons of other types, such as ideological motivations of external pressures.

Section 3 focuses on the implementation of privatization as public policy. The following conclusions emerge:

- The mode of implementation is not neutral.
- There are no optimum implementation models applicable to any case or country.
- Privatization models based on auctions which allow for significant premiums over the minimum price have been important in Brazil, because they generate support for implementation of this policy.
- The choice of order of companies to be privatized is important.
- Privatizations are not implemented only on the basis of the political will of the executive branch of government, but there is also a need for coalitions sustaining them, outside the more closed center of government circles, for them to be implemented.
- In the case of Brazil, the support of society for privatizations of public services has given the executive additional degrees of freedom for their implementation.
- The choice between open-outcry auctions and closed enveloped auctions is also part of a more general context associated with the *implementation of privatization as public policy*, and is not based only on the perception of maximizing proceeds.

¹ For a wide-ranging view of the implementation of privatizations in the period and their implications for the reform of the State in Brazil, see Velasco Jr. (1997a and 1997b). The bibliographical references used in this present paper are also part of the Velasco texts.

Section 4 concentrates on the view of privatization as a means of de-privatizing the State, freeing funds for society which were previously appropriate by specific interest groups. Additionally, and because of this view, the myth of unconditional support by business as a whole for privatizations is questioned.

Finally, Section 5 discusses the perception, which is judged to be mistaken, that coalitions which have made implementation of privatizations possible automatically reproduce themselves at the moment when the state which emerges from privatizations of public services begins to act – the stage of the “State as regulator”.

2. Privatizations in the Sarney government: motivation was neither ideology nor external pressure

At the end of the Sarney government, in March 1989, 17 privatization processes had been completed, generating revenue equivalent to US\$ 549 million, and transfer of debt of the order of US\$ 620 million to the private sector². The fact that three important industrial companies were included in this list assumes from significant: Eletrosiderúrgica Brasileira (Sibra), at that time the largest producer of ferro-alloys; Aracruz Celulose, one of the largest paper and pulp companies; and Caraíba Metais, the only copper smelter in the country. Further, the state steel holding company Siderbrás decided to sell control of two of its companies: Cia. Ferro e Aço Vitória (Cofavi) and Usinas Siderúrgicas da Bahia (Usiba).

Contrary to the commonly held perception that these privatizations were the result of ideological motivations or external pressures, we shall seek to show that the circumstances of the period do not lead to such conclusions. We argue that these privatizations took place for internal BNDES reasons, and in spite of the fact that adjustments of a reform nature were not in fact part of the public agenda at the time.

According to Almeida (1996), the agenda of the first civil government, after the military government of 1964-1984, was characterized by efforts to dominate inflation without using economic policies regarded as orthodox. The consciousness of the nature of this crisis – especially of the relationship between the fiscal crisis, patterns of state intervention and inflation – took shape only slowly and irregularly among the political elite. Even at the end of the Sarney government, subjects such as fiscal austerity, deregulation, privatization, and trade liberalization had made only a tenuous penetration into debate among technocrats and academics. Indeed, the government which followed the military period had the same faith as its predecessors in the state as manager of strategies for development. The democratic alliance, which was opposed to authoritarianism, basically had in mind the correction of the authoritarian strategies for

² Figures based on the “1985-1989” report of the Federal Privatization Council (*Conselho Federal de Desestatização*), and on figures presented in *Privatization: the experience of BNDESpar in 1987-1989*, a document prepared by the BNDES; with some conciliation of criteria.

growth, and the concept of endowing them with a social bias. Rejection of adjustment policies was deeply rooted in all the segments which formed the opposition to the military government: fiscal imbalance was seen as a legitimate strategy to stimulate economic growth.

The emphasis given by Sarney to reforms of the political system finds a parallel in what took place in the Argentina of Raul Alfonsin, in the post-military period. The Alfonsin government also gave precedence to reconstruction of democratic institutions, taking only moderate steps in economic reforms, or even postponing them, with a view to preserving the consensus between the various social and political forces. Economic problems were seen as resulting from the ineptitude of the military government and the absence of democracy – and this diagnosis was also applicable to the Brazil of Sarney. Whether for lack of perception, or whether for lack of internal consensus, the question of the weaknesses of the public sector and the more structural nature of the economic crisis did not have priority in the public agenda [Canitrot & Sigal (1994), Nelson (1994), Palermo (1995) and Torre (1995)].

- It is true that there was an anti-statist environment among the more influential sections of business since the Geisel period, causally related to the beginning of a cycle of economic decline and the exclusion of business from the more important centers of decision on formulating economic policy. However, the businessmen who were part of this current of opinion did not have a long term project able to overcome the internal conflicts of their class and, consequently, did not have a proposal to put forward which would be consistent with a change in the dominant statist view [Diniz & Boschi (1998) and Diniz (1990)].
- Thus, the contracting of international loans in the 1980s did not have the effect of setting off a policy of structural adjustments in the Sarney government, whether due to expansionist pressures coming from the heterogeneous coalition which supported the government, or whether as a result of the history of the Brazilian developmentist model [Kaufman (1989 and 1990)]. As Stallings (1992) analyzed the impact of international forces influencing the changes in economic policies of the non-central countries in the 1980s, Brazil was among those which moved in the direction of structural reforms only at the end of the decade: it was internal factors which played a significant part in the Sarney government.
- On the other hand, a look at the privatizations which did take place shows the strong participation of the BNDES. Of the 17 sales, 11 were of companies controlled by BNDESpar, a wholly owned subsidiary of BNDES, and two – those related to Siderbrás – were managed by BNDESpar in the role of privatization agent for Siderbrás. Some 98% of the proceeds were directly or indirectly obtained through action of the BNDES System.
- The reasons for privatizations in that period can thus be better understood from a reading of a document published by the BNDES System in 1992, *Privatization: the experience of BNDESpar in 1987-1989*. The following primary reasons are extracted from this document:

- The large number of companies controlled by BNDESpar were responsible for more than 50% of its total volume of disbursements in the period 1982-85 – these disbursements were basically to pay for the expenses of these subsidiaries, relegating to the background investments in minority holdings, one of the objects of the bylaws of BNDESpar.
 - efforts were directed to operational and financial monitoring of these companies, since they were all in an extremely critical situation;
 - injection of capital into these subsidiary companies turned out to be ineffective, in the context which involved the state companies at that time: the difficulty of ensuring a professional management, limited management flexibility to operate in competitive markets, and the difficulty of maintaining a stable policy of price adjustments, due to the practice of using state companies to avoid feeding inflation;
 - BNDESpar reported successive losses from 1982 to 1987, and their causes were attributed to the factors in the items above.

That is to say, it is more reasonable to deduce that the reasons for privatizations in the period were BNDES reasons than to have recourse to explanations based on ideological motivations or external pressures. This, indeed, is to see the BNDES as a rational agent capable of taking strategic decisions in its own interest.

In the BNDES document mentioned above, this question becomes even clearer, when the bank's policy of acting as an agent for privatization of non-controlled companies, because of directly or indirectly held financial responsibilities, is justified. The sales of Cofavi and Usiba were based on this logic. They were both known to be in a difficult situation, and the BNDES had loan receivables from both. The implicit expectation was to find new controlling stockholders who could save the companies financially, or at least improve the quality of the credits: to replace debtors who were, under the Brazilian legislation, not executable, by private sector debtors, who are executable³.

The fact is that, looking further forward, it can be seen that this was only the visible part of an enormous iceberg. In the National Privatization Program (PND), instituted in 1990 in the Collor government, the past due debts of the state companies, directly or indirectly the responsibility of the Treasury, became accepted as a form of payment. For this, debt had to be certified and renegotiated by the Treasury, a process which became known as securitization of debt. The state steel sector was one of the principal generators of these debts, as a result of the insolvency situation of Siderbrás and most of its companies. BNDES had securitized credits, resulting from its exposure to the sector, of a total equivalent to approximately US\$ 1.7 billion (representing currency conversion at the time the securitization deals were done). Of this total, some US\$ 400 million resulted from credits owed by Siderbrás itself, and the rest, US\$ 1.4 billion, from receivables owed by

³ It is important to point out that the BNDES was not the manager of the federal privatization program in the Sarney administration – as it later came to be in the Collor government. It became the *privatization agent* for Siderbrás, the Brazilian government steel holding company, and for the sales of Cofavi and Usiba, by specific contracts signed with Siderbrás.

the steel companies. The amount of this debt was not compatible with these companies' capacity to generate funds⁴.

Conceptually, the total of US\$ 1.7 billion can be seen as the potential total of insolvency of the steel sector in payments due to the BNDES. This amount surfaced as a result of the PND, having previously been masked by successive renegotiations. With this amount securitized, the BNDES acquired a real potential for recovery of these credits, to the extent that it could sell them to investors who wished to buy shares in the state companies under the PND legislation. This did indeed take place, and for the BNDES it meant replacing the federal Treasury as a debtor with private economic groups. Seen in another way: an exchange of non-executable credits for executable credits, in the same way as took place in the Sarney period.

This picture shows the strategic importance of the privatizations for the BNDES, and especially, for the steel sector. On the other hand, it was not only a question of reducing the BNDES's objectives to recovery of credit. The BNDES, as the principal agency of long-term financing in the country, was in a privileged position to evaluate the consequences of the financial crisis of the state. Investments in the steel sector had come to a halt, even if only because, under the legislation in force, the BNDES was prevented from financing the sector, due to the level of the sector's debt⁵. With the exception of Usiminas, all the steel companies were urgently in need of significant investment, either for modernization or for expansion. In other words, it would not be possible to separate the interest of the BNDES in recovering credits and its interest in supporting the development of the sector – the two motives were indissolubly linked.

In a more generic manner, this view on the reasons for privatizations in the Sarney period is endorsed by Schneider (1991), for whom the privatizations had less to do with the Privatization Council, created at that time by the government, than with the BNDES's desire to recycle the allocation of its funds. According to Schneider, due to the not highly pro-privatization position of the government, the surprising fact is that there was a privatization program, and that it went so far. Similarly, the private sector not only had had no influence whatever, but had also fought behind the scenes against privatization, in spite of publicly professing its support for the program⁶. On the other hand, to the extent

⁴ With the exception of Usiminas and CST, all the other state steel companies were in a financial and economic situation which was incompatible with the volume of their sales revenue and the average profitability of the sector, based on international comparisons. By reason of their size, Cosipa, CSN and Açominas were the companies which generated the largest volume of securitized debt, in the financial restructurings which were carried out under the PND (National Privatization Program). Note that no new debts or obligations were created for the Treasury, since the Treasury itself, as guarantor, was effectively the debtor for all the past due debt.

⁵ This impossibility resulted from Central Bank Resolution 469 of March 21, 1998, which prevented an increase in the indebtedness of public companies in relation to its value on December 31, 1987. The relationship with the sector consisted almost entirely of constant restructuring of the credits already in existence. Financings by the BNDES for investments were only resumed, through the BNDES's regular credit lines, after the privatization of the Siderbrás group companies.

⁶ It is interesting to note that this statement is in line with the pressure exercised against the privatization of Carifba Metais by the principal rolling and drawing companies which acquired its products, which formally requested that the

that the companies being sold were not key items in Sarney's political game, Sarney was able to endorse the proposals made by the bureaucracy⁷.

Concluding, and summing up: subject to this observation by Schneider on the government's endorsement of privatizations, it can be said that privatizations were the product of a specific government agency, which decided, and strategically implemented, a public policy which was not specifically part of the agenda of the Executive branch of government.

3. Mistaken impressions associated with the implementation of the privatizations

There has been emphasis in the literature on the difference between the phases of formulation⁸ and implementation of economic reforms. In the same way that no reform can be introduced without some autonomy in relation to the pressures from groups which live on financial gains, it is also true that no reform can be successful unless a coalition of beneficiaries is created, or appealed to. This would be true even for the reforms whose objective is the reduction of the role of the State in the economy, such as privatizations. Implementation depends on political support of different groups of beneficiaries in the private sector and, at least, the acquiescence of the strongest political forces which compete within the political system. Without tacit or explicit alliances between politicians, the technocratic elites and those which benefit from the reform efforts, the attempt to change tends to be frustrated [Haggard & Kaufman (1993)]. The approach based on the autonomy of the state presupposes something which is impossible: the existence of an entity with independence of will and independent capacity to act. In this respect, success and failure in implementation of economic policies are associated with the coalitions which are formed [Conaghan & Malloy (1994)]. The technocratic style of decision, usual in recent democracies, is seen as incompatible with continuity of the economic reforms. It would be a mistake to adopt the idea that, in a democratic regime, resistances can be overcome by force or that reforms can be put through so rapidly that the groups affected do not have time to organize themselves and act against them [Bresser Pereira, Maravall & Przeworski (1993)].

On the other hand, there is the paradox that the State itself is the instrument promoting changes in the direction of a less statist situation, generating a conceptual problem for implementation of the policies [Kahler (1989)]. More recently, the literature has been

BNDES should cancel and annul the sale process. Since these companies benefited from the fact that Caraiba suffered permanently from its prices lagging behind inflation, this request was seen as an attempt to maintain the status quo.

⁷ In fact, at the end of the administration, in the period before the presidential elections, the privatization processes were suspended at the order of the president himself. The reason was the intense controversy surrounding the process of privatization of Mafersa, which was in progress at the time. Later, in the Collor administration, this company, also controlled by the BNDES, was privatized without controversy.

⁸ The literature sees the process of formulation as including not only the formulation itself but also the phase of initiation of the reforms, showing that the authors are concerned with the capacity of governments to implement their objectives in full, or at least, without allowing their objectives to be deprived, by only partial implementation, of their original qualities.

using the concept of governance to define the capacity of the state in formulating and implementing its policies in a coherent and consistent fashion, being, thus, capable of coordinating them amidst different interests involved without the normal play of democracy being eliminated [Diniz (1995)].

That is to say: the choice of the form of implementation of public policies depends on specific contexts of each period and each country. There are no optimal models for implementation applicable to any particular case. Indeed, the concept of efficiency depends on how it is defined. Ringen (1987), for example, evaluating the policy of the Welfare State, subordinates the concept of efficiency of the policy to its legitimacy. Inefficiencies cannot be considered as such, if the results with which they are associated arise from a democratic process of public choice. This is to say, these apparent inefficiencies become, in themselves, a possible result which has been legitimately obtained.

This brief review of the literature is enough to give a better idea of the concepts which we judge to have been mistaken in relation to implementation of privatizations.

3.1. The question of privatization sale models

Although this is apparently an obvious statement, the basic point of public policy, in the case of privatization, is that it should indeed be implemented. It is thus a question of creating the conditions for this to happen. Models held to be theoretically optimal may not be accepted by the society or by the players directly interested, and can often be transformed into veritable obstacles to achievement of the planned aims. The simple political will of the Executive Power by itself is not sufficient.

It is worth using as a reference the experiences of implementation of privatization in the UK and France, in the 80s and 90s, which, not without reason, were not incorporated into the Brazilian privatizations.

The privatizations in the UK are strongly associated with the sale of shares for a fixed price, very widely spread in the market, on a large scale, on stock exchanges: large scale flotations. This was the model, which prevailed in the principal sales of the UK companies, such as British Telecom and British Gas, in the 80s, and the electricity sector in the 90s. As a result of the privatization program, the total number of stockholders tripled from 1981 to 1992: in 1981, 7% of the population owned stock; in 1992, 22% of the population owned stock. The sale of British Telecom alone created one million new investors [Wright (1994) and Brito (1989)].

The reasons which led a particular privatization model to be chosen were not always easy to detect, because they frequently become confused with the reasons related to the formation of the coalition necessary to sustain implementation of the privatizations. Wright calls attention to the fact that the quality of rationality attributed to many of the privatizations in the UK took shape subsequently to the programs themselves, rather than preceding them. In his opinion, this rationale was created, afterwards, to justify what came before. If on the one hand the Thatcher government created the idea that the objective of the model adopted was "to take capitalism to the people", authors such as

Richardson (1994), and Wright (1994) understood that the large-scale sale model was basically a strategy to accommodate interests, aiming to implement the privatization which was financially attractive to the public as a whole, among which some key players were included: managers and employees of the state companies, the consuming public, financial institutions, and the major institution investors. Moreover: in the case of the privatization of British Telecom, British Gas and the British Airports Authority, these companies were maintained intact in their near-monopoly structure, in order to ensure speed and attractiveness for their sales. The ideology of the government itself, centered on maximizing the efficiency of a system of allocation of resources based on economic competition, gave way to a larger objective, which was the implementation, per se, of privatizations.

In France, the privatizations were invariably associated with the constitution of a group of stable stockholders (GSS) selected by the French government from outside the stock market. This sale took place after a public offering, in the UK mould, with the selected group of stockholders paying an additional price to that of the public offer. There was a concern that the participants of the GSS, over the whole of the series of privatizations, should represent a significant sample of the whole range of interests in the French business world – the majority were chosen for one, or two, transactions, at most [Dumez & Jenemaitre (1994)].

The sale model based on large scale flotations can be seen as the one which was judged able to overcome rejection by public opinion and create a network sustaining the implementation of privatizations in the UK. Similarly, it may be understood that the creation of the GSS functioned as a great coalition sustaining the French privatization program.

3.2. Auctions, “as opposed to” fixed-price sale

An initial reaction to the above would be that none of the models was constructed with the specific purpose of maximizing proceeds. Seen in other way, it could be said the maximization of proceeds is important if, and only if, it is judged to be important by society – i.e., it is capable of generating support for the implementation of privatization. Since in the particular case of Brazil, the question of the public deficit has strong support, privatization is characterized as a policy able to contribute to reduction of the State’s financial problems. In this respect, models seen in one way or another as maximizers of proceeds are important for the Brazilian cases. Hence most of the reason for the fact that auctions have been adopted as the basic model for sale, in spite of the legislation of the PND allowing for fixed-price sales of stock, in such a way as spread ownership as widely as possible among the public. Hence, too, the importance attributed to the premiums obtained on the sales, in relation to the minimum prices stipulated.

Auctions and premiums have been important, above all, in Brazil because they generated support from the implementation of privatization as a public policy. Independently of the question of the size of the Brazilian capital market, it could not be imagined that the Brazilian government, in the period under study, could have sold its companies for a fixed

price – and, let us emphasize, an attractive price – as in the UK or even in France⁹. Indeed, it is surprising that, in the cases in which privatizations most directly affected consumers, for example sales of control of electricity distributors and telecoms service providers, the influence of the prices paid by investors on tariffs and on future investments did not receive greater attention from the media. The premiums, which represent maximization of proceeds, have been praised as an unquestionable public good, without any consideration at all being given to the question of whether they might make it more difficult to reduce tariffs (and how fast) in the future¹⁰.

3.3. Privatization models and the coalitions to sustain them

A second reaction has to do with the question of coalitions to sustain privatizations. The UK and France provided appropriate solutions for their respective conditions, but these would be hard to reproduce in Brazil, especially if we think of the beginning of the Collor government.

With the end of the “BNDES phase”, in the Sarney government, the subject of privatization did indeed gain the status of a priority in the public agenda in the Collor period, with the institution of a large-scale federal privatization program – the present PND. A change of level represented by the PND can be seen from a comparison of results: at the end of the Collor government, 16 privatization processes had been concluded, for a total value of approximately US\$ 3.9 billion, compared with proceeds of US\$ 549 million in 17 processes, in the previous period.

The question here is to try to understand how this was possible. After all, it cannot be imagined that the non-existence of a consensus in our society on priority for reforms associated with the neo-liberal view – this lack of consensus permeated the whole of the Sarney government – suddenly was dissipated at one blow. A study by the Soares de Lima and Boschi, in 1994 (i.e., more than a year after the Collor government), shows the Brazilian elite taking a position which at the very least can be called reticent in that period on market-oriented economic reforms – and by elites we mean congressmen, public administrators, businessmen and union leaders. This was especially true in the case of the reforms which involved redistribution of economic resources and of power, such as some of the initiatives to modernize the State [Soares de Lima and Boschi (1994)]. Above all, Collor took power without a party support base and also without organized support of the segments of society as a whole. He did not, in fact, have a neo-liberal mandate. That is to say: the diffused support for an anti-state rhetoric, provided by the votes he received, was not transformed, necessarily, into support for a policy of privatizations [Schneider (1990)].

⁹ The National Privatization Council’s decision not to adopt this model for the privatization of CVRD, which might have been appropriate for it, is a good example. Indeed, in an explanatory booklet, the BNDES, among other reasoning, argued in favor of the decision not to sell the common (voting) shares in CVRD widely in the market since this would result in lower proceeds for the federal government.

¹⁰ In principal, the regulators’ room for maneuver is reduced when the investor pays higher prices, in that the return on the investment will demand higher tariffs.

From the BNDES document referred to above – *Privatization: the experience of BNDESpa in the period 1987-1989* – we observe that the model most frequently adopted in this period, the sale of shares in a single block, with pre-qualification of candidates, had been chosen because the companies to be sold had neither a history of profits nor an economic scale which suggested the development of alternative models, such as widely-spread sale of stockholding in the market. Although the BNDES's reasons can be understood, this was a precarious model in terms of implementation, as Schneider (1991) observed, because it was supported by the victory of only a few¹¹. And, very probably, this was the reason why the model was changed by the BNDES itself, when it became the manager of the PND. However, in this phase Usiminas was chosen, as a leading case, in a role similar to that played by Entel, the telecoms company of Argentina, in the Menem government [Palermo (1995) and Torre (1995)].

The choice of Usiminas – a profitable company, technologically up-to-date and of a significant size – obeyed a double logic. On the one side, it supplied credibility to the program. As in the case of Entel, it represented a break with the past, the quest for a “capital” of confidence in the world of business, and the leading case for a new political orientation – as set out by Palermo (1995). At the same time, it was an opportunity to review the sale model which had been adopted until then, the model of sale in a single block, in an attempt to overcome the precariousness of the support inherent in that, previous, model. Clearly Usiminas also had other important qualities. First, since Siderbrás was in the process of liquidation, the corporatist resistances were reduced to those within the company itself, in contrast to the companies in the petrochemicals and fertilizers sectors, which had the corporation of Petrobrás behind them. Secondly, Usiminas was a company which had the conditions to be privatized, without a prior financial restructuring being necessary.

It is important to emphasize that the choice of Usiminas also obeyed a logic of implementation of public policy: the choice of a leading case which was more visible, rather than a choice which involved a learning curve initially gained from starting privatizations with less important companies – indeed, some sections of society argued for this course at a time¹².

The sale model adopted for Usiminas, which was subsequently reproduced for almost all the privatizations in the Collor and Itamar Franco governments, did not previously define

¹¹ The general view found in the literature on the implementation of reformist policies points in the direction of widening the number of beneficiaries – which was, in the limit, what was sought in the UK. At the time the BNDES was significantly criticized for adopting a model which was seen as tending to concentrate, and tending to give preference to purchasers which already had a base installed in the same sectors as the companies being sold. This tends to reinforce the argument that the BNDES sought to implement the privatizations in the form which was in keeping with its objectives, in spite of the resistance to the policy in itself, and resistance to the form of execution. For more details on this point, see Velasco Jr., (1997a).

¹² There seems to be no doubt that this option was adopted on the basis of the experience acquired by the BNDES in the previous period. In spite of the lesser relative importance of the companies, and thus their lower visibility for the public in general, practically all the privatization processes faced resistance, including successive court challenges which temporarily held up auctions. That is to say, the theory of a “learning curve” as a means of gaining support was not in line with the BNDES's practical experience. The Entel case is presented as an argument in favor of this type of choice, since, in the experience of the offers cited, it is a parallel.

the format of the final controlling stockholding block. The system of sale by public auctions, which had been established in the Sarney era, remained the basic sale method. The block of stock was offered without setting any minimum quantity of stock to be acquired¹³, or a technical pre-qualification of candidates. Any investor could bid, in accordance with its interests – this was the only really fundamental condition, other than proving that the investor was up-to-date with payment of taxes, and had made the necessary deposits of financial amounts in relation to the auction. The result of the auction could be anywhere between two extremes: acquisition of the entire lot by a single purchaser, or its division between an extremely wide range of different investors. This model, thus, allowed for there being a larger number of winners, although it did not guarantee this would happen.

Indeed, the format of the voting capital structure of Usiminas after its sale turned out to be completely different from the patterns which had been known in Brazil up to that time. Investors with interests which were in principle divergent found themselves involved in an unprecedented shared ownership model. Banks, private sector companies from various industries, employees¹⁴ and the employees' pension funds of the companies sold, pension funds of other state companies, and of private companies, came to see that co-existence in a professionally-managed company, along the lines of some major US corporations, was not impossible¹⁵. It was not even essential to have a strategic investor who was a specialist in the business – what developed was a dissociation between ownership and management of the business. And it did not matter whether, subsequently, there were re-concentrations of ownership, since this came to be seen, simply, as one more business possibility for the various investors.

Fundamentally, this model admitted the co-existence of investors with different point of view, who came to see privatizations as a business opportunity compatible with their capacity to mobilize funds, whatever the value of the privatization¹⁶. The number of winners was thus widened, making possible the support coalition necessary to the implementation of the PND¹⁷. The success of this model was proven with its repetition in

¹³ To be precise, minimum share lots were established, aiming to be operationally appropriate for financial settlement; but since they were not large, they cannot be seen as a restriction against participation by investors wishing to acquire only small positions.

¹⁴ As was done in other countries, the employees were encouraged to take part, since they were given access to as much as 10% of the voting stock, on special favorable terms.

¹⁵ The final stockholding structure, for the voting stock, was as follows: BNDES 0.6%; Nippon-Usiminas 13.8%; other existing stockholders 0.3%; employees 9.6%; CVRD 15%; Banco do Brasil employees' pension fund (Previ) 15%; CVRD employees' pension fund (Valia) 7.7%; 17 other private pension funds 3.4%; Banco Bozano, Simonsen 7.6%; Banco Econômico 5.7%; other financial institutions 14.9%; steel distribution companies 4.4%; other new investors: 2%.

¹⁶ Clearly this model gained strength from the form of financing allowed by the program: acceptance of the so-called privatization currencies as means of payment, which were freely negotiable, vastly enlarged the universe of investors.

¹⁷ It is interesting to observe that the participation of the employees and the employee pension funds of state companies widened the base of support, in that it created, for people in the state sector, the prospect of democratic capitalism, and the press, at the time, discussed the subject in these terms. Later, employees, CVRD, and the pension funds of the state companies participated significantly in other auctions, consolidating this model. Note that in the Franco administration, the Banco do Brasil employees' pension fund had the largest holding in the voting stock of Acesita (15%), followed by the employees (12.4%).

practically all of the following cases which, like Usiminas, involved the sale of stockholdings of significant value.

It can be concluded that, in the Collor government, privatizations were not implemented only based on the political will of the executive branch. A coalition to sustain them based in the business community was created, compensating the absence of a wider support from the political classes and the elites in general¹⁸.

We should also comment on what might be called the Usiminas model. This model was exemplary in its adequacy to the view of the crisis of the Brazilian State at that time, which had to do with a shortage of governability, or governance [Sola (1993) and Diniz (1995)], especially one of the dimensions of the concept of governance, as seen by Diniz, which is the State's capacity to command and direct, setting priorities and putting them in order. The Usiminas model was not concerned with setting targets for the structure of ownership, and did not seek any responsibility in setting directives for industrial policy. A model with set objectives might have tended not only to reduce the number of winners, but also to produce less uncertain winners. As such, it might have created a level of opposition on the part of the losers, which the government, with its lack of governance, might perhaps not have been able to overcome. A fact that demands our attention is that this model continued to be the basic model in the Itamar Franco government – in spite of the Franco government having assumed a climate of strong distrust in relation to all the policies developed by the Collor government, especially those seen as reformist policies. One might have expected, at least, a substantial revision of the directions of the PND¹⁹, but the model based on “uncertainty on who would be the winner” and on “the opportunity for the losers to become winners in other privatizations” prevailed. The role of the State was, fundamentally, to ensure neutrality of the processes²⁰.

Some variations on the same theme can be seen later, when in another context, in the Cardoso government – elected with more defined support basis – privatization as a public policy faced less resistance – indeed this was partly due to the government's higher capacity for governance.

¹⁸ In fact, this comment can be extended to the Franco administration, since in spite of intentions for change, the basic model of implementation of privatizations remained the same.

¹⁹ The swearing-in speech of BNDES president Antonio Barros de Castro gave signals in this direction: “(...) privatization should be understood as an instrument in the process of restructuring of the private sector”. Further, at the beginning of the administration, important privatization auctions, such as those of Ultrafértil and CSN, were suspended – but were resumed later with practically no change in the minimum prices or the model of sale.

²⁰ It is worth qualifying the question of non-interference in two situations:

- (1) In sales of companies with a stockholders' agreement – where restrictions were placed on free transfer of shares (the most notorious case being in petrochemicals) – the government did not succeed in renegotiating the essence of these agreements, making clear the difficulty of implementing privatizations in a more “managed” form.
- (2) In the only privatization in which the government was allowed to keep a single share with special powers – that of Eletromecânica Celma (aircraft motor building, repair and maintenance), this took place at the request of the Air Ministry.

The privatizations of public services provide an initial field for analysis. The sale of Light, in May 1996, still preserved the same basic structure of the Usiminas model. But later, the privatization of state and federal public services moved back – the most important change – to sales of a single block²¹. Technically speaking, it is not difficult to justify this decision. On the one hand, in a country where the major corporations in which management and ownership structures were separate was still only incipient, it seemed more convenient to the regulatory agencies that there should be a previously defined controlling block. On the other hand, perhaps more importantly, in view of the scarcity of domestic capital to make up the amounts involved in these privatizations, the sale of a single block reduced the level of uncertainty of foreign investors on the mobilization of the necessary funds, and on the partners with whom they would have to relate²². From the point of view of implementation itself, this technical change came to be possible not only because privatization no longer carried the stigma of a change in the concept of the state as the main motor of development, to which society had been habituated, but also because the federal and state governments now had this same society, generically speaking, as its ally in new projects, due to the deterioration in the quality of public services provided²³. That is to say, the support of the business community, which had been a feature of the Collor and Itamar governments, could be replaced by a new support base, which was much wider. The concept of seeking to maximize sale proceeds, however, continued, with the use of the auction mechanism, whether by open outcry, or by closed envelope.

This perception strengthens when we try to understand why there was so much controversy over the sale of CVRD, in May 1997 – with a profusion of legal actions trying to prevent the auction. Indeed, the fact that the government succeeded in privatizing a large and leading company such as CVRD itself indicated that, in spite of all the difficulties, the government had acquired a capacity for governance of this type of public policy. However, the difficulties may perhaps be explained on the basis of the partial break with the Usiminas model, of sale of a single block²⁴, as had already happened in the sales of electricity companies – though without a counterpart support base that was more clearly defined. In the CVRD sale, restrictions were established on the maximum

²¹ In fact, in the privatization of Escelsa, the other federally-controlled electricity distributor, at the beginning of the Cardoso government in July 1995, a single block was also sold, but this decision cannot be seen as a change in the model, because it was justified on the basis of a specific situation: the existence of a private-sector stockholder in the company with 21% of the voting stock. If the full Usiminas model had been adopted this would have meant favoring this group. The observation made here basically covers the electricity companies of the states, and Gerasul, sold in September 1998.

²² This was probably one of the main reasons why Light was sold at the minimum price – although the uncertainty, at the time, over whether privatization of electricity sector would continue, and the absence of a defined regulatory environment, probably also had some influence.

²³ In the case of the federal companies, the support of society was even more important, since proceeds from privatizations were legally required to be used to pay debt – thus eliminating one more step in negotiation of support for the BNDES, involving beneficiaries of public policies on industrial or social investment which could be carried out with the privatization proceeds. In the case of the companies controlled by the individual states, it can be supposed that there was already some support from the beneficiaries on the expenditure which would be carried out using the proceeds of the sales, whether for financing current expenditure or for investment.

²⁴ To be more precise, investors could make bids for a minimum of 40% and a maximum of 45% of the voting stock, the federal government maintaining some 30% for sale later.

number of shares which could be acquired by companies linked to the steel or mining sectors, and the new controlling stockholders were obliged to constitute a special-purpose company, with previously defined bylaws, obliging them to a specific prior agreement between themselves. This meant, principally, a break with the concept of non-interference which had been present in the Usiminas model, with the government setting itself up to conduct a privatization in a more directed fashion, and, thus, having to face, at least, the withdrawal of support from investors which had been accustomed to not being previously excluded from the negotiations involving pre-formed groups²⁵. On the other hand, in contrast to the case of the public services, society appears as only a diffuse beneficiary of the privatization of a company which had been held up as an extremely efficient example of a state company. It is thus not unexpected that the privatization of CVRD became a veritable battlefield. The legal actions seeking to restrain the auction from taking place should be seen, basically, as a result of non-formation of a wider support base, either on the investors' side, or on the side of society²⁶.

3.4. Types of auctions: open outcry "as opposed to" closed envelope

This is one more mistaken issue: there is no dichotomy between the two methods, in the sense that one is necessarily better than the other. Indeed, the choice of method of sale arises from and is essentially a part of the context of implementation of public policy.

In the first place, there is a confusion in simple comparison between open outcry and closed-envelope auctions. There must be a prior choice, which is whether (a) only offers for a single indivisible block of stock will be accepted, or whether (b) partial offers will be accepted. The closed-envelope system is a choice associated with the decision to sell stock in a single block. Thus it makes little sense to question the choice of open outcry for sales which follow the Usiminas model.

²⁵ Illustrating this: in the Usiminas model an investor able on his own to raise funds to acquire, for example, 5% of the shares being offered, would in the last resort be able to force entry into a previously formed group interested in acquiring a larger holding, on pain of pushing up the price significantly and thus making the purchase by the larger group cease to be viable. For this reason, the controlling groups tended to acquire their final structure only after the auction. With the repetition of this type of sale, this type of agreement came to be accepted as normal by investors.

²⁶ Clearly, the experience acquired in the case of CVRD indicated to the managers of privatizations the need for more explanations, to the judiciary and to the inspection agencies, on the objectives and the technical methods adopted, with a view to reducing the difficulties to be faced in subsequent privatizations. Prior to the Telebrás sale, for example, seminars were held with judges of the lower courts and the Appeal Courts, and the technical staff and ministers of the Federal Audit Court. However, this need to inform key segments of society does not by itself explain what happened at the privatization of CVRD. It is enough to note that only two court actions were filed against the sale of Light, the privatization immediately before CVRD – a much lower number that was to be expected based on the experience of the legal department of the BNDES in relation to other privatizations of large companies. That is to say, the fact that Light is an important electricity distribution company was not enough to stimulate a large proportion of society to put up a legal challenge to the program. Later, the problems of this type faced at the Telebrás privatization can also be seen as not very significant, if we take into account the scale of the process, which involved a prior accounting and stockholding restructuring on a scale that was unprecedented in Brazil: a split of the 26 local telephone companies, to produce 26 separate cellular companies, and the split of Telebrás into 12 new holding companies. In the cases of both Telebrás and Light, it can be considered that the support of society functioned as a sustaining coalition which allowed the privatizations to be implemented without major conflicts.

Secondly, even in the case of sales of indivisible blocks of stock, there is no consensus in the literature on the existence of models which clearly maximize value. There is, on the other hand, in essence, an analysis of the types of auctions and the logic of ways of seeking to maximize proceeds. For example, types include the so-called Dutch auction, in which the auction begins at a high price which is reduced with each round of bids until one bidder promises to pay the price announced; and the so-called Vickrey auction, in which the party making the highest bid, having been declared the winner, pays the amount offered by the second-placed bidder – that is to say the amount of the highest offer refused²⁷. In practical terms, if the objective is a successfully implemented auction, Dutch or Vickrey type auctions, or any other type which may be imagined and which may be unlikely to be supported by public opinion, tends to be discarded. One can imagine, for example, a Dutch auction in which there are various bids at the first price offered; or, the difficulty of explaining a Vickrey auction in which the use of the second highest price as a winning bid is put forward as a means of maximizing proceeds.

Observing the privatizations since the Sarney era, it is seen that the use of the closed envelope auction as an instrument of sale is a more recent choice associated with the sale of indivisible blocks of the shares of public service companies. The sale of indivisible control blocks, or of large stockholdings, in turn, represented a later abandonment of the Usiminas model, for the reasons explained above. However, in the federal sphere, open outcry auctions were not only the dominant method adopted in the Sarney period, when sales were made by offers of indivisible blocks or of assets, but also in the Collor and Itamar Franco periods, and most recently in the first Cardoso government, until the privatization of the Telebrás System, when the closed envelope method began to be used²⁸.

There are reasons for this. Open outcry auctions are seen by society as being more transparent. An open outcry dispute between interested investors, with the possibility of escalating bids, in a place to which public access is easy, such as the stock exchanges, provides a sensation of more uncertainty about the result of the sale, and consequently more neutrality in the method. Further, the open outcry auction makes possible greater support by both the winners and the losers. Bids are not won by a large margin, funds are thus not wasted, and one is not a loser when the bid offered does not represent the maximum that one is disposed to bid.

That is to say, these auctions tend to be more appropriate from the point of view of implementation of public policy, when the support of society is not yet consolidated. And even when the two methods are mixed, using the closed envelope for the initial bids and subsequently an open outcry dispute between the highest bids – as adopted in the case of Telebrás – this option does not signify only an attempt to achieve the maximum proceeds. The introduction of an open outcry auction, after the closed envelopes having been opened, at least overcomes any frustration on the part of the losers who were

²⁷ For an outline of the types of auction, see Feldman and Mehra (1993).

²⁸ At the individual-state level, the sale of Cerj in November 1995 was the first for which the closed-envelope system was chosen. The system later became standard for the sale of control of the state-level electricity distribution companies.

closest to the winning bid, reducing one of the levels of the conflict inherent in the closed-envelope type of sale.

It can thus be said that the mixed type of auction, more recently adopted in the federal sphere, involving closed envelope bids and open outcry bids, is an evolution of the method of sale which can be used when privatization as a public policy has already been more widely divulged and accepted. Or, seen from another angle, it can be supposed that an attempt to implement federal privatization by other methods than open outcry in the Sarney government, or at the initial phases of the PND, would have been at least a more difficult task²⁹.

4. The invisible part of the contribution of privatizations; and the myth of unconditional support by business

The PND legislation provides a good reference on what to expect from privatizations. Among the program's objectives are re-ordering of the State's strategic position in the economy, contribution to reduction of the public debt, and increasing the competitiveness of the country's industry.

Usually associated with these objectives is the raising of funds – and what raising of funds means in terms of reducing public debt. Other aspects are: increases in productivity and efficiency of the various sectors of the economy, as a result of greater flexibility and speed in taking of private decisions.

There is a less visible part of this iceberg, for which it is worth having recourse to Olson's perception on what he calls distributive coalitions. Olson applies the potential of his theory on the logic of collective action³⁰, in drawing up a pessimistic view on the economic systems of modern societies. Public or collective goods are subject to the action of organized groups, which benefit differently from these goods and share the costs with society. It is in this sense that the author characterizes them as distributive

²⁹ The question of which method is capable of producing higher purchase bids is not the relevant discussion – even if only because experience does not permit any generalization. As an example, take two cases: the sale of 35% of the voting shares of CRT (Cia. Riograndense de Telecomunicações), by closed envelope, in December 1996, when the difference between the winning and the second-placed bid was less than 1%; and the sale of control of Embratel, in July 1998, through a mixed system, when in the initial bid, by closed envelopes, the difference between the first two bids was around 1%. In the subsequent open-outcry auction, the second-placed bidder went some 6% above the originally winning bid. Thus, leaving aside the question of implementation dealt with in the main text above, the mixed auction system, currently in use, can be seen to be a practical and acceptable method which seeks to reduce the negative aspects inherent in the two methods involve.

³⁰ According to the theory, groups of different sizes, even if they have common interests, have unequal probabilities of organizing themselves for a collective action, in the absence of coercion or of selective incentives. Small groups and those with homogeneous interests have a larger propensity to behave as a “privileged” unit, fleeing from a pattern (admittedly, rational) of non-cooperation. The reason for this is that in these groups the individual contribution and the resulting benefits are perceptible to the group as a whole; in other words, since the net benefit is perceptible to all those involved, collective action can be and tends to be voluntary [Olson (1965)].

coalitions³¹. These coalitions reduce the efficiency and the aggregate income of societies, at the same time as they also reduce the society's capacity to adapt to new circumstances through reallocation of resources and the use of new technology [Olson (1982)].

Olson's concern can be associated with the "capture" of the State by interest groups. And, in this sense, privatization appears as one of the forms of dealing with this question, by reducing the number of state-controlled objects, of whatever nature, which are able to be captured³².

In fact, the concept of capture of the State enables us to draw back the curtain on the invisible part of the contribution of privatizations to the adjustment of the public accounts and of the competitiveness of the different sectors of the economy. It is not only the funds raised which count. Nor the alleged greater efficiency intrinsic to the private sector. In truth, what is also on the agenda is a de-privatization of the State, by means of privatizations.

The BNDES's reasons for the privatizations implemented in the Sarney period, set out above, are illustrative of this point. The BNDES was concerned, basically, with the volume of funds injected into its subsidiaries without any prospect of return, and with the fruitless directing of its efforts as an institution to the financial and operational monitoring of these companies³³. That is to say, privatization, in this period, could be seen as the solution adopted by the BNDES to deal with the rent-seeking to which these subsidiary companies were probably being submitted. It could be said that, for the BNDES, more important than the funds raised from the sales were the funds that they would cease to inject into the companies, with no return, and the freeing of the time of their technical staff for their proper activities. As such, this solution – the sale of the companies – was part of an objective of recovering the bank's capacity to intervene in the economy.

The notion of de-privatization of the State also makes it possible to question another myth, which is the unconditional support of the business world for privatizations. Usually resistance to privatizations is associated with unions or with parts of society understood to be contrary to government policy, such as opposition political parties. Schneider,

³¹ Other names for the same type of concept are found in the literature, such as interest groups or rent-seekers. We have tried to preserve the denomination given by Olson, in the work cited in the bibliography. For the purposes of this present text, distributive coalitions can refer to any interest group, such as labor unions, government workers, managers of state-controlled companies, or private-sector companies which have a commercial link with companies producing public goods.

³² It is worth emphasizing that Olson's perception is being understood for the case of companies controlled by the state, which were not the specific object of his analysis. Indeed – a detail – one of his concerns at the time he was writing was the growing power of the labor unions. Further, even in the case of companies controlled by the state, privatization should be seen as aiming to confront the problem of capture by interest groups. An opposing line would be to increase the power of the state, on the supposition that this would make it more able to deal with the question.

³³ As reported in the document cited in section 2, *Privatization: the experience of BNDESPar in 1987-1989*, the BNDES came up against the need to become involved in the management and routine of the companies it controlled, thus having to exercise a role outside its objects as laid down in its bylaws, and one for which it was not organized in structural terms.

however, had already detected that, in the Sarney period, for example, the private sector not only had no influence in the implementation of privatizations, but also had fought against it, behind the scenes, in spite of publicly professing its support for the program [Schneider (1991)]. The support is, thus, theoretical. After all, if there is de-privatization of the State, there are identifiable losers in the business world in each privatization process³⁴.

5. The “regulator-state” after privatization, and what we may expect from it

With the privatizations of public services at full steam, and the landmark of the Telebrás privatization behind us, some reflections on the significance of this new State which is emerging in Brazil are appropriate.

The market-oriented economic reforms which have been carried out in Brazil bring with them the question of whether they are, an end in themselves, or only part of a redesigning of the role of the State. Put another way, it can be asked whether the objective of the economic growth will be better met by a State which is merely smaller, reduced in its role, or by a new State redefined in terms of its capacity to intervene.

The point to be emphasized has to do with the false perception that the support which has made implementation of privatizations possible is reproduced, automatically, at the moment when the State which emerges from these privatizations takes action.

It could be understood that the widespread support for privatizations which, progressively, extended throughout society since the beginning of the decade, took place not only because of the need to raise funds to adjust the public accounts, but also because of the acceptance of the theory that it was necessary to allow a more effective action by the state in activities regarded as typically those of a state, such as health, education and public safety. Although this simplified view of the state is an abstraction, the reduction of its functions became a welcomed recipe for freeing the state from the action of interest groups which, in their different ways and at their different levels, benefited from the public goods and shared the costs with society as a whole, as outlined above.

With the privatizations executed, it can be imagined that the current level of consensus will give way to some differences related, especially, to regulation. On the one side, there will be those who see the reduction of the role of the state as an end in itself, and on the other, those who see it as a means.

In terms of the regulatory role of the state, it is a question of better understanding the discussions which will certainly take place in the coming years on the scope and depth of this activity.

³⁴ As well as the example cited above in the footnote in Section 2, on the resistance perceived by the BNDES from businessmen to the privatization of Carajás Metais, it is interesting to cite the study by Gandara e Kaufman Consultores Associados (1994) on the privatizations of the Brazilian steel sector. They say that the steel privatizations resulted in an aggregate saving of US\$460 million, arising from productivity gains, optimization of the production base, and, *principally, from renegotiation of contracts with third parties.*

For those who argue for a reduced role for the state, the way of facing the problem of its capture by private interests is to circumscribe the scope of its functions. Put in another way, the idea of a planner-state or a state which is hyperactive in this new exercise of its regulatory activities would be contrary to the sense of contemporary complex societies, in which there is only a minimum possibility of foreseeing the results of the infinite interactions between the individuals and economic agents. Interventions with a certain objective can generate unforeseen results, in a direction contrary to the direction desired. In this sense, regulation should be limited to general rules, and it is not desirable for the State to take more specifically one-off and interventionist action³⁵.

In spite of the recent institutionalization of the regulatory agencies, such as Anatel (the telecommunications regulator), Aneel (the electricity regulator), and ANP (the oil regulator), with obligations defined by law, the question of the limits of the intervention of the state is still an open one, if only due to the simple fact that this new state is at an embryonic stage and has thus not yet been appropriately tested.

The role reserved for Anatel, for example, as reflected in the concession contracts made with the current telephone companies, envisages wide scope for those who desire a State which has recovered and redefined its capacity to intervene, regardless of the possibility of its being “captured” by interest groups.

Theories and ideas apart, there remains the question of the future performance of the current allies when the regulatory agencies begin to be demanded in situations of clear conflict. It is worth remembering some not-so-distant experiences of the regulatory agencies of the UK. In 1991, for example, the Office of Fair Trading recommended that British Gas, already privatized, should separate its gas supply and selling operations from its transport operation, without this new structure having been envisaged at the time of the sale of the company³⁶, and that, by 1995, the company’s stake in the industrial gas segment should be reduced from 90% to 40% [Richardson (1994)]. Another example was when the Office of Electricity Regulation, in March 1995, decided to re-evaluate, in favor of consumers, the price structure of the sector, which had been set in August of the previous year to be valid for five years, from April 1995 – generating controversy about the agency’s power [The Economist (1995)].

It may thus be supposed, perhaps, that there will be less calm days in the coming decade, in comparison with the current support for the market-oriented reforms. At the least, we may expect a reconfiguration of alliances, and it should be no surprise if segments which today are in favor of privatizations may in the future take sides with those who today oppose them. And it will be on the basis of this scenario of dispute and confrontation of ideas that the Brazilian regulator-state will acquire its features.

³⁵ For more on this way of thinking, see Hayek (1973).

³⁶ Although the result of this impasse is not relevant for the purposes of this present text, it is worth mentioning that the company appealed to another government agency, the Monopolies and Mergers Commission, which accepted an intermediary solution: instead of transforming the transport unit into another company, separation between the two business areas – transport and sales – was accepted with the adoption of a so-called Chinese wall [House (1995)].

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