

Case Study (Full Report)

The “State-of-the-Art” of State-Owned Enterprises in Brazil

Carlos Sérgio Figueiredo Tautz, Fabricia de Andrade Ramos, João Roberto Lopes Pinto, Pedro Amaral Serra, & Rodrigo Valente Serra, June 2014

Introduction

Public access to information on governmental budgets and spending is an important means of empowering civil society to actively participate in improving policy choices. Assessing budget transparency, however, is a complex task in the contemporary state. Many aspects of a government’s structures and procedures must be analyzed, from the legal framework to the availability and quality of information and from the different types of investments and expenditures to the intricate systems of resource distribution.

Moreover, the state’s use of public resources is not limited to the direct administration of the country. In most nations, governments also distribute resources to public corporations, autarchies, foundations, and other entities that have hybrid legal statutes to pursue public interests and/or state functions in competition with the private sector. For this reason, the International Budget Partnership (IBP), under its Open Budget Initiative (OBI), has recognized both the potential impact of state-owned enterprises (SOEs) on budgets and the importance of public access to information with regard to transfers and uses of funds by these corporations.

In the last three assessments (2006, 2008, and 2010) done by IBP through its Open Budget Survey, Brazil has scored between 71 and 74 points in the questionnaire based on the existence and on the level of information contained in eight key budget documents, of which Brazil published six.¹ The Pre-Budget statement (*Lei de Diretrizes Orçamentárias – LDO*), the Executive’s Budget Proposal, the Enacted Budget (*Lei Orçamentária Anual – LOA*), and the In-Year Reports were all judged to have extensive or significant information, while the Year-End Report (*Prestação de Contas da Presidência da República*) and the Audit Report (*Relatório e Pareceres do Tribunal de Contas da União*) were published

¹In IBP’s Open Budget Questionnaire classifications, Brazil does not publish the Mid-Year Report and the Citizen Budget. With regard to the first, there are some bimestrial reports required both by the Fiscal Responsibility Law and the pre-budget document in case the established financial program and annual chronogram of disbursements cannot guarantee the accomplishment of goals for primary results. These bimestrial reports show the limiting of endowments and financial transfers and contain a) the old and new estimates of primary revenue and expenses and the demonstrated necessity of these limitations at the percentages and amounts established; b) the revised projections of variables pertinent to reach the goals; c) the justifications for altering necessary expenses and explaining the measures adopted to deal with and the impacts on credits caused by this alteration; d) the calculations of frustrated primary revenue and their updated demonstrations, justifying the deviation from the originally determined course; e) the updated estimates of the primary surplus of SOEs and the associated calculations that become necessary. As for the Citizen Budget, the Ministry of Planning, Budget, and Governance (MPOG) has launched in 2010 the report entitled “Federal Budget at Everyone’s Reach” (*Orçamento Federal ao Alcance de Todos*), which presents a simplified version, accompanied by budgetary explanations of the Government’s proposal for the Enacted Budget for each year. These reports are available on the MPOG’s website, under the “Budgetary Education” tab (including versions in English) for the years of 2010 and 2011, see <http://www.orcamentofederal.gov.br/educacao-orcamentaria/ofat/ofat>.

but had only some of the relevant content. However, this survey contains just two questions that bear directly on SOEs, which frequently represent large portions of the national economy, provide essential public services and enable infrastructure and economic development.

Quasi-fiscal activities of the state are another crucial for aspect of SOEs for international organizations focused on budget, transparency, and accountability of governments, such as the International Monetary Fund (IMF) and IBP. According to these organizations such activities act as “hidden expenditures” that are invisible on budget documents and tend to benefit narrow groups in society. These organizations argue for the elimination of these activities, or at the very least their complete transparency in budget reports that include an evaluation of their fiscal impacts. These activities are commonly undertaken by SOEs and state-owned banks through resource transfers or prices below market rates that allow for profit, such as subsidized loans or noncommercial public services run by SOEs. IBP also points out that the purposes of these quasi-fiscal activities could be achieved by specific taxes and subsidies or even by direct expenditures, but then they would necessarily be reported on the budget books.

The IMF, in the *Manual on Fiscal Transparency* (2007), requires that key budget documentation include all quasi-fiscal activities, including statements on purposes, durations, and intended beneficiaries. The IMF points out that public financial institutions “have often been set up to provide assistance of a quasi-fiscal nature, such as a development bank providing loans to specific sectors at below-market rates. Governments also use public financial corporations on a more ad hoc basis to provide quasi-fiscal assistance, for example, through policy-directed lending.”²

As for national resource companies, the IMF says that these “are often responsible for both commercial operations and noncommercial activities, such as the provision of social or other services normally provided by the government; specific requirements for employment; and the provision of products at less than cost recovery or below-market prices for domestic consumption. Clarity of fiscal policy requires that the ministry of finance oversee such noncommercial activities.” According to the IMF, good practice would be a clear separation between the commercial and noncommercial activities of the companies, submitting the first to government ministries and the latter to private sector principles.

In this research paper, we will provide readers first with a a) a brief historical overview on Brazilian state and SOE development; b) the legal and institutional frameworks currently in place for Brazil’s SOEs; c) the availability of information regarding budget and activities; d) the legislative and external oversights on the entities; and e) the public participation allowed by existing structures and procedures. From this general standpoint, we then analyze two very significant Brazilian SOEs – the National Bank for Economic and Social Development (BNDES) and the petroleum and oil company Petrobrás – and provide detailed information on their legal framework and institutional

“The Federal Law of Transparency and Access to Public Government Information (FLTAGPI), passed in 2002, requires federal agencies to respond to information requests from citizens.”

² IMF. *Manual on Fiscal Transparency* (2007). p. 26.

organization, which reflect the complexity and diversity of these entities. We discuss as well the challenges and potentials to promote transparency and civil control over them. In conclusion, the Guidelines on Corporate Governance by SOEs published in 2005 by the Organisation for Economic Co-operation and Development (OECD) and the IMF's Manual on Fiscal Transparency (2007) serve as the international benchmarks for state ownership of enterprises; we offer a brief assessment of Brazil's compliance with these standards. Finally, questions on government practices regarding SOEs will be suggested for potential use by the IBP in international comparative assessments such as the Open Budget Index and Questionnaire.

Brief History

Although the first Brazilian SOEs date from the imperial period – such as the Bank of Brazil (BB) in 1808 and the Caixa Econômica Federal (Caixa) in 1861 – most of the stimulus for the expansion of this sector, especially to explore economic activities, came only in the 1940s, after the Brazilian state, a democratic and federal republic since 1889, definitively lost its agrarian orientation and took a sharp turn toward modernization through industrialization and urbanization. From this period until the establishment of the current democratic order in 1988, the Brazilian state has traditionally invested directly in sectors in which private capital had no interest in or lacked the financial capacity to do so. The first significant period coincides with the governments, both authoritarian and democratic, of President Getúlio Vargas, who created massive SOEs, such as National Steel Company (CSN) in 1941, the Vale do Rio Doce Company (Vale) in 1942, the BNDES in 1952, and Petrobrás in 1953. After a brief period of democracy with few changes in this sector, the second period in which numerous SOEs were created was the military regime that lasted from the 1960s to the end of the 1980s, when EMBRAER (aircraft manufacturer) INFRAERO (airspace regulator), EMBRATEL (telephone), Correios (mail), and RADIOBRÁS (radio, TV, and other telecommunications) enterprises, among others, were created. Thus, the industrialization process in Brazil was largely state-induced, and large public investments were made in energy production, mining, and petroleum extraction and later in infrastructure and telecommunications.

Even so, state ownership of enterprises in Brazil was reduced significantly during the 1990s with a series of privatizations that allowed huge transfers of public investments into the private sector and promoted the emergence of huge private conglomerates that were often controlled or owned by foreign investors. This change was embodied in the National Plan for Privatizations, launched in 1990 and sustained through the decade, and led to privatizing CSN in 1993, EMBRAER in 1994, and Vale do Rio Doce Company in 1997. The privatizations sparked arguments within society and among politicians, with accusations of rigged and underpriced sales of companies and diversion of public funds into private accounts; others raised questions about the nature of the privatizations and the institutional and financial relationship that persisted between the state and the SOEs.

As of 2003, there was a clear shift toward the strengthening of private national companies or groups, and both the state and the entrepreneurs have been collaborating to create “national champions” or “global leading” corporations. Nonetheless, Brazil still has a bulging state-owned sector composed of over one hundred federal SOEs that have undertaken complex activities or roles in the national economy and development. These roles are generally divided, in all key budget documents, between the state's Productive Sector (SPE) and the Federal Financial Institutions (IFF), the latter being mostly banks and including far fewer enterprises than the former. The Constitution refers to SOEs as the state's indirect administrative body, where their main role is to maintain autonomously a certain delegated activity, while still being legally and institutionally bound to the central government structure, through any of various ministries and executive offices. In this way, SOEs are hybrid entities that span public and private sectors' obligations and undertakings are organized to compete with similar private corporations, but remain subject to the principles that guide public offices – such as legality, morality, and transparency. While the Constitution is the main document that regulates

SOEs, it does so in scattered areas of the text and not in a chapter or section exclusively dedicated to these entities.

Legal and Institutional Framework

Legal framework

Brazil's economic and financial order, as established in a specific chapter of the Constitution, is founded upon principles of free and competitive markets, incentives toward private initiative, and respect for private property, but it is also guided by the goals of reducing inequalities, creating full employment, and protecting property and the environment.³ Since these principles often become incompatible, the state must act as a mediator, establishing which should take precedence and how they should be applied.

According to the constitution, the direct exploration of economic activities by the state is only acceptable if necessary to national security or if relevant to public and collective interests. Each SOE that meets these conditions must be specifically created by a law that defines its scope of action.⁴ At a minimum, each such law must include five basic aspects: 1) the social function of the SOE and ways in which both state and society will monitor performance; 2) the adoption of the legal regime of private enterprises with regard to civil, commercial, labor, and fiscal rights and obligations; 3) the observance of public competitive bidding procedures for any external hiring, buying, selling, building, and servicing that may be involved with the SOE's activity; 4) the composition and procedures concerning the board of directors and other existing boards; and 5) the mandates, performance evaluations, and legal responsibilities of the administrators.⁵

“To prevent abuse of power, the Constitution determines that SOEs cannot receive any fiscal incentives and discounts that could not be extended to other corporations in the private sector.”

To prevent abuse of power, the Constitution determines that SOEs cannot receive any fiscal incentives and discounts that could not be extended to other corporations in the private sector, demanding legal punishment for any attempts to dominate markets, eliminate competition, or elevate profits arbitrarily.⁶ On the other hand, there is also a clear constitutional effort to guarantee the respect of public principles and practices by the SOEs, such as having to observe the public competitive bidding procedures and the public principle of transparency.^{7,8} The ground rules for SOEs laid out by the Constitution were further detailed by complementary laws, such as the one on fiscal responsibility, published in 2000 and later updated in 2009, that thoroughly organizes the

³ Brazilian Constitution, chapter on *General Principles of Economic Activity* under the Title VII “*Of the Economic and Financial Order*”, articles 170 to 181.

⁴ Article 173 and §1º, Federal Constitution of 1988, available at http://www.planalto.gov.br/ccivil_03/constituicao/ConstituicaoCompilado.htm

⁵ Article 173, §1º, Federal Constitution of 1988

⁶ Article 173, §§2º e 4º, Federal Constitution of 1988.

⁷ Article 37, II, Federal Constitution of 1988.

⁸ Article 37, §1º, Federal Constitution of 1988.

instruments and policies, rules and limitations, for state's management of public budget and finances.⁹

At this point, it becomes crucial for us to widen the scope of our research to include the broader Brazilian budgetary situation and the role of SOEs, especially the federal financial institutions, such as BNDES. Understanding the law of fiscal responsibility is necessary for unveiling the maneuvers used by the government to obtain primary budget surpluses, while keeping massive resources flowing to both national and private companies through public banks during an international economic crisis. We will not address the complexity of the financial operations and budgetary bureaucracy in this brief assessment; our objective is merely to articulate the concepts of budgetary practices, transparency, and quasi-fiscal activities in the Brazilian political and economic context, illustrating how it occurs in practice through the key legislations and budget documents.

In Brazil, the public debt can be divided into the consolidated debt (*dívida consolidada ou fundada*), composed of the total financial obligations undertaken by the state through laws, contracts, agreements, treaties, and credit obligations that will exceed 12 months, and the fluctuating debt, which was defined by a previous and complementary law as being composed by "unpaid bills" (*restos a pagar*), amortizations and interest rates on the consolidated debt, third-party guarantees and collaterals, and National Treasury debts (AROs). In contrast with the consolidated debt, the fluctuating debt does not need previous legal authorization to be acquired, must be internal (i.e., national), and usually is short-term.¹⁰ This difference is important because the fluctuating debt does not involve the budgetary system, meaning it is not contemplated in the process of accounting for available funds, resource destination, revenue and expenditure compensations, additional credits, and the execution of the Enacted Budget. The fluctuating debt is thus harder to identify and control and serves as a massive and fertile field for government manipulation of balances.

In this context, the law of fiscal responsibility can also be analyzed not through what it contains, but rather through what is absent in its text. President Fernando Henrique Cardoso vetoed an article from the law that attempted to regulate "unpaid bills," which represent the total amount of financial obligations previewed in the Enacted Budget or acquired throughout the fiscal year that were not executed in that same period. The proposed rule was to allow the insertion of expenditures (debts) as "unpaid bills" if they were legally authorized and liquidated, but not actually paid in that fiscal year; or legally authorized, not yet liquidated, but held accountable through laws, contracts, agreements, or adjustments to any of these, signed, publicized, and ongoing in that fiscal year.¹¹ In this way the law theoretically determined that in the beginning of the new fiscal year, the "unpaid bills" would be deducted from the available funds, followed by the pledging of new expenditures and transfers of resources, up until the limit established.

The Presidential veto argued that this rule regarding "unpaid bills" allowed the insertion of expenditures in the budget without constraining them necessarily to the availability of funds and fiscal necessities of the next year. This could create a dire situation if the previous year's expenditures compromised the legal budget for the upcoming fiscal year. When this provision was cut from the legal text, the regulation of "unpaid bills" wasn't subject to any alternative policy, meaning that Brazil has no procedure that allows the identification, transparency, and control of these

⁹ Lei Complementar nº 101 de 2000 (*law of fiscal responsibility*), available at http://www.tesouro.fazenda.gov.br/hp/downloads/lei_responsabilidade/lc101_2000.pdf

¹⁰ Lei nº 4.320 de 1964, available at http://www.planalto.gov.br/ccivil_03/leis/L4320.htm. See Article 92.

¹¹ Liquidated means that the service that created the expenditure has been concluded and recognized by the public entity that acquired the debt.

expenditures. This becomes even clearer in light of the fact that the veto rendered another article ineffective: originally, to compose the regulation policy proposed for the “unpaid bills,” one of the main budget balance reports produced by government entities – the Fiscal Management Report (*Relatório de Gestão Fiscal*) – should have contained the demonstrations of the expenditures inscribed as “unpaid bills,” discriminating between debts: 1) liquidated and to be paid; 2) authorized, not yet liquidated, and previously inscribed to be paid; 3) authorized, not yet liquidated, and inscribed within fiscal limitations of that year; and 4) canceled due to lack of liquidation, regular inscription, and/or available funds.^{12, 13} Together, both the vetoed and the ineffective articles of the law of fiscal responsibility would have regulated and made more transparent the execution of the governmental budget in the fiscal year and according to the Enacted Budget. Without these, the “unpaid bills” are invisible and are not taken into consideration when the year’s budget is discussed. As many specialists and the media warned, this has created a “parallel budget” that competes for resources and funds with the Enacted Budget. For the government, however, this “parallel budget” becomes a strategy to maintain the fiscal balances positive, reaching primary budget surpluses arbitrarily, since it can manage the appearance of these “unpaid bills” in the budget. It can do so both by postponing the payment of the liquidated expenditures for the next year without it composing necessarily that year’s fiscal execution program or by postponing the recognition of executed services that liquidate these expenditures.¹⁴

In 2011, while President Dilma Rouseff announced cuts on government expenditures that amounted to approximately US\$24 billion, an economist from the Institute of Applied Economic Research (IPEA)¹⁵ pointed out that these cuts contemplate only expenditures contained in the Enacted Budget and its execution, which leave out the “unpaid bills.” Rouseff’s government, still according to the IPEA specialist, has to deal with a total of about US\$63 billion in “unpaid bills” that grew steadily from 2005, when that year’s unexecuted debts were US\$4 billion less than in 2004, summing to US\$10.7 billion. The “unpaid bills” have grown six times in approximately six years. The biggest concern regards the increase in “unpaid bills” that were authorized but not yet liquidated (or not recognized as such) for two main reasons: first, they can still be canceled, since they are expenditures that, supposedly, have not yet been executed; and second, they have been growing rapidly in authorizations (pledges) and payments since 2006. For example, while in 2003, some US\$3 billion “unpaid bills” not yet liquidated were paid, in 2010 this amount was US\$21 billion. In 2011 the “unpaid bills” in this category (i.e., not necessarily paid) amounted to over US\$50 billion.

Although the lack of information on the “unpaid bills” makes it harder to demonstrate the multiple trajectories traced by public funds from their origin to their destination, the constant increase of this “hidden” debt has been clearly accompanied by a sustained or increasing flow of public resources from the National Treasury to public banks, such as the BNDES, and, correspondingly, a steady and robust rate of disbursement destined to stimulate private and public enterprises. According to the IPEA specialist, these transfers to BNDES, done through the issuing of public debt bonds in the market, which are later loaned to the bank for a lower interest rate, are then loaned again by BNDES at limited interest rates to beneficiaries of their programs and credit lines. Not only does this generate a revenue loss in many cases – although the government says the contrary – but it is also common

¹² According to the law of fiscal responsibility, there are three main budget documents produced by the government: the fiscal management report, the concise report on budget execution, and the annual report on activities.

¹³ These two first classifications refer to Article 41, I and II, respectively, of the law of fiscal responsibility.

¹⁴ Manueto Almeida, “Restos a pagar, truques fiscais e orçamento paralelo.” 25 February 2011, available at <http://mansueto.wordpress.com/2011/02/25/restos-a-pagar-e-truques-fiscais/>

¹⁵ The economist is Manueto Almeida, who works in the Instituto de Pesquisas Econômicas Aplicadas (IPEA), which is a public foundation and, thus, part of the Federal indirect administration.

that resources pledged by the state to the bank or by the bank to the programs, lines, and beneficiaries are not paid out in the same fiscal year and end up in the “unpaid bills.”

Regarding the transfer of public funds into the private sector, the law of fiscal responsibility determines that any resource from the National Treasury directly or indirectly destined to “cover the necessities of people or debts of corporations” must be authorized previously by its own specific law, must be in conformity with the pre-budget document, and must be previewed in the budget or its additional credits. By “transferring,” the law included loaning, financing, refinancing, creating debts or prorogating their collection, subsidizing and subventions, and participating in any sort of capitalization. This rule, still according to the law of fiscal responsibility, applies to all of the indirect administration, including foundations and SOEs, with the exception of public financial institutions and the Central Bank when undertaking their essential activities.¹⁶ This exception enables the Brazilian government’s policy of transferring public funds to multiple investments through its public banks, such as the Central Bank, the Banco do Brasil (BB), the Caixa Econômica Federal (Caixa), and the BNDES, which is by far the main financial instrument for this policy. In this way, neither transfers from the Treasury to the BNDES, nor from the BNDES to public or private corporations, necessarily observe the criteria of conformation with key budget documents. Similar exceptions regarding federal financial institutions can be found when the law treats the concession of guarantees by public entities: while the whole of the indirect administration, its enterprises and subsidiaries, are prohibited from grant guarantees in any venture, including those in which the pledged resources already have funds destined to cover them, the granting of guarantees between SOEs and their controlled or subsidiary companies or between public financial institutions and SOEs is allowed.¹⁷

Speaking of guarantees, Brazil published in 2005 a new law on the financial recuperations and bankruptcy of enterprises that expressly does not apply to SOEs, without discriminating between those which offer essential public services – whose exception from these procedures would be acceptable – and those which explore economic activities and should compete equally with private companies as established by the Constitution.¹⁸ This has generated a huge debate among scholars, politicians, lawyers, and others. In practice, there are no judicial decisions that determine whether an SOE that explores an economic activity is subject to the new law or not, but most interpreters and important jurisprudence on parallel themes suggest that only essential public services are exempt from these procedures. The legal uncertainty is already enough to create doubt and insecurity among analysts and investors, making the SOE sector more vulnerable to political influences that affect market behavior. Even if out of the new law’s legal scope, public or private entities that offer public services are still held civilly responsible for the damages and losses that their personnel, acting within their professions, cause to third parties. Because the Constitution specifies entities that offer public services, it is understood that there is no underlying government responsibility for the damages or losses caused by SOEs that only explore economic activities, such as the financial institutions and the SOEs in the productive sector.

Institutional framework

All SOEs are officially bound to various ministries and public executive offices. The complex system of SOE ownership and responsibility is further complicated because each specific law and internal statute – the two main documents to create a SOE – defines the relationship between the public enterprise and its supervising ministry. For this reason, the composition of the boards of SOEs varies

¹⁶ Article 26, §§1º and 2º of the Lei Complementar nº 101 de 2000 (*law of fiscal responsibility*).

¹⁷ Article 40, §§6º and 7º of the Lei Complementar nº 101 de 2000 (*law of fiscal responsibility*).

¹⁸ Lei nº 11.101 de 2005, available at: <http://www.planalto.gov.br/ccivil_03/_ato2004-2006/2005/lei/111105.htm>.

significantly, and it is common for the supervising ministry to hold most of the seats, while other activity-related ministries also have their share of representatives, as does the employee's organization and company executives. Brazil's President appoints the representatives of the public to the SOE board.

As for the high positions in the administrative structure, many of these are also appointed by the country's President, because they are considered, legally, to be offices of public trust. Since the Constitution established that the SOEs are subject to the principles of public administration, it means that both the board of directors and the top administrative offices must act within legal boundaries, act with no personal interest, observe the administrative morality, be transparent about the company's performance and their own work, and act efficiently in pursuit of public and collective interests. Board members and appointed high officials are subject to civil, penal, and administrative laws regarding ethics, and any misconduct could lead to judicial consequences, although the administrative and penal laws are difficult to enforce because they require proof of intention to harm the company or the public interest, and mere bad administration will not suffice.

Although there is no general legal statute devoted entirely to organizing and regulating the SOEs, these entities are all monitored by the Ministry of Planning, Budget, and Governance (MPOG) and more specifically, by its Department for Coordination and Governance of SOEs (DEST).^{19, 20} Among other attributions, the MPOG elaborates, monitors, and evaluates the budget documents under executive initiative and responsibility, coordinates the public-private joint ventures and partnerships, administers federal patrimony, and modernizes public administration. This ministry also elaborates guidelines and criteria for corporate governance of SOEs, interacting with multilateral and international organizations on budget and strategic planning systems.

Within this structure, DEST deals strictly with SOEs and their subsidiaries and controlled companies, participating in all possible phases of SOE creation, merging, restructuring, and extinction. DEST is responsible for formulating the investment budget proposal that integrating the main governmental budget documents – the Pre-Budget statement and Enacted Budget. In addition, the department elaborates and publishes the two official aggregated SOE reports, the Profile of SOEs and the Annual Report. These may enable society to better assess this sector, since in all other legal budget documents, such as the Year-End Report and the Audit Report, SOE-related information is scattered between the Fiscal and Social Security Budget, which contains information on all state-dependent corporations and some of state-controlled enterprises disbursements, and the investment budget, which is exclusively devoted to SOEs.^{21, 22}

Transparency and Budget Documentation

As part of government, even if indirectly, SOEs are considered in all key budget documents, from the Pre-Budget statement, to the Enacted Budget, to the Year-End Report (*Prestação de Contas da Presidência da República*). In these, however, SOEs are not analyzed separately, but are categorized

¹⁹ Ministério de Planejamento, Orçamento e Gestão, available at <http://www.planejamento.gov.br/>

²⁰ Departamento de Coordenação e Governança de Empresas Estatais, available at <http://www.planejamento.gov.br/secretaria.asp?cat=20&sec=4>

²¹ Prestação de Contas do Presidente da República. 2010, available at <http://www.cgu.gov.br/Publicacoes/PrestacaoContasPresidente/2010/Sumario.asp>

²² Relatórios e pareceres do Tribunal de Contas da União, available at http://portal2.tcu.gov.br/portal/page/portal/TCU/comunidades/contas/contas_governo/contas_10/CG%202010%20Relat%C3%B3rio.pdf

between “state-controlled corporations” and “state-dependent corporations.” In the former, the government owns all or the majority of the SOE’s social capital, but there are multiple revenue sources due to the nature or activity of the enterprise; in the latter, the government is necessarily the only shareholder and must cover all of the SOE’s expenses. State-dependent enterprises are treated in the Fiscal and the Social Security Budgets, while state-controlled corporations, which involve shareholding, asset or service provision, loan payment, or specific application of the funds in the productive regional structures, are dealt with in the Investment Budget.²³ In legal documents, this Investment Budget is usually referred to as the one dedicated to SOEs, and it does include the vast majority of SOEs at the federal level.

In the last Open Budget Questionnaire (2010), Brazilian representatives distinguished between state-dependent corporations and state-controlled financial institutions (such as the BNDES) and state-controlled productive enterprises, such as Petrobrás.²⁴ As explained by the Brazilian consultant for OBI 2010:

“The budget of state banks [state-controlled IFFs] is not part of the draft budget law, but only those investments that are made such as construction, equipment, etc. Our point is that there is an enormous financial asset in the state banks that is not dealt with in the referenced [budget] documents. BNDES is the biggest example of this.”²⁵

Because of the fine legal line between public and private aspects of SOE’s – especially those which deal with private capital investments and generate revenue – the Pre-Budget statement has established that all their sources of financial investment must be reported separately in order to illustrate the SOE’s own income production, the government’s participation in the SOE’s social capital, the credit operations with both internal and external financial institutions, among other criteria.²⁶

Transparency

The Profile of SOEs contains an overall assessment of the SOE sector. In 2011, there were 122 SOEs at the federal level, of which 105 were state-controlled, composing the investment budget, being monitored by specific budget and fiscal guidelines, while 17 are state-dependent. In addition, 103 SOEs were considered part of the state’s Productive Sector (SPE), and 19 were financial institutions (IFF). The Profile is organized according to the latter distinction, presenting information on all SPE enterprises – categorized by Petrobrás and its subsidiaries, Eletrobrás and its subsidiaries, other state-controlled productive enterprises, and state-dependent corporations – followed by the financial institutions and their information. Analyses by sector are limited: SPEs are ranked according to their activity, patrimony, profit and losses, number of employees, and other categories. The information on each specific group, such as Petrobrás, is reduced and focuses mostly on employee distribution and simple statements on total investments (approximately US\$50 billion in 2010) and

²³ For this research paper, the Pre-Budget statement used as reference was the one for fiscal year 2012. Article 6º *caput* e §1º, III, da *Lei de Diretrizes Orçamentárias nº 12.465 de 2011*. Here, “investment” is considered to be the acquisition of fixed assets (with some exceptions, improvements of all sorts done by SOEs on government assets, and necessary improvements to public infrastructure or services under the SOE’s responsibility), available at http://www.planalto.gov.br/ccivil_03/_Ato2011-2014/2011/Lei/L12465.htm

²⁴ IBP. and OBI, Open Budget Questionnaire, Brazil 2010, available at <http://internationalbudget.org/wp-content/uploads/2011/04/Brazil-OBI2010QuestionnaireFinal.pdf>

²⁵ Some information can be found in the financial annual report, “*Demonstrações Contábeis*,” available at http://www.bndes.gov.br/SiteBNDES/export/sites/default/bndes_pt/Galerias/Arquivos/empresa/RelAnual/ra2010/DemonstracoesContabeis2010.pdf

²⁶ Article 51, §3º da *Lei de Diretrizes Orçamentárias nº 12.465 de 2011*.

consolidated liquid profit (around US\$18 billion for the same year). An important note in this report points to the fact that the amount invested is not based on the same concept of “investment” used in the Pre-Budget statement, which is more restrictive. Thus the amounts declared by the company differ from those contained in the government’s investment budget, pointing to a lack in transparency.²⁷ There is no analysis on their financial sources or on the destination of transferred resources. Information on the public financial institutions is similar.

Financial balances and budget details are at the end of the Profile and detail the official information, such as the law that created it, the SOE’s address, contact numbers and purpose, the board of directors, and details for two years on the amount of revenue, deductions and expenditures, and the balance of profits or deficits. This is strictly a financial report, which means that there are no indicators that examine equity ratios or capital adequacies. In the section titled “Additional Value Demonstrations,” there is a general differentiation between additional value produced by the own company and the additional value received through transfers. However, there are no clear presentations of the resources received from public transfers from the Treasury or other sources. The Annual Report elaborated by DEST focuses more on explanations of the processes of budget planning, proposition, enactment and execution, although it also offers extensive financial information for each SOE and for the various sectors. This type of information has been produced by DEST since 1981, which makes comparative assessments possible, although the information has only been available in annual documents for the last four to five years.

The information published is extensive, especially on processes and budget structure and organization, but because of terminology and extensive monetary data, the financial demonstrations are not comprehensible to the general public for purposes of transparency and accountability. The reports leave out essential information for social control over expenditure and investments of public patrimony, such as specific fund destinations and the exact resource allocations. There is also no contextual information for outside of the SOE segment, such as the size of this sector in the national economy and its impact on the GDP.

Key budget documentation

All of the key budget documentation produced by the Federal Government can be found in the official website dedicated to this area.²⁸ The Pre-Budget Statement is a set of ground rules the Enacted Budget must observe, both establishing limits and goals and detailing procedure for budgetary accounting and accountability.²⁹ Based on the separation between the Fiscal and Social Security Budget and the Investment Budget, the Pre-Budget Statement determines that the budget document – elaborated by the Executive and submitted to congress before being amended and enacted – must have an appendix for each budget that contains, among other things, expenditures reported in six categories, including payrolls, interest and other rates on debts, investments, capitalizations, and so on. In these appendices, expenditures should be organized according to their institutional and budgetary entity, for which the values should be presented by function, subfunction, expenditure’s nature, and fund source as declared in the Enacted Budget up until two years prior.

²⁷Profile of SOEs report 2010, footnote 3, p. 17.

²⁸ Ministry of Planning, Budget and Governance (MPOG), *Secretaria de Orçamento e Finanças (SOF), Orçamento Federal. Orçamentos Anuais*, available at <http://www.orcamentofederal.gov.br/orcamentos-anuais>

²⁹ For this research paper, the Pre-Budget statement used as reference was the one for fiscal year 2012. Lei nº 12.465 de 2011, available at http://www.planalto.gov.br/ccivil_03/ Ato2011-2014/2011/Lei/L12465.htm

The Enacted Budget is a piece of legislature that indicates the available funds for each part of the government's budget (both Fiscal and Social Security and Investment Budgets) and the total amount of the expenditures. The main document deals only with total amounts and their distribution through the appropriate budget division, as well as the rules for authorizing additional or supplementary credits. The Enacted Budget contains the appendices referred to above, in which the financial sources for each budget are briefly spelled out. The budget related to the SOEs by definition differentiates sources between their own revenue, resources destined to increase liquid capital, the internal and external long-term credit operations, and other resources with long-term schemes from the controlling company, debentures, and others. The volumes, of which only the last (VI in the Enacted Budget for 2012), refers to the Investment Budget and the SOEs exclusively, but it must be noted that other SOE expenditures are included in the Fiscal and Social Security Budget – meaning that the this sector is not completely aggregated in key budget documents that follow this logic.³⁰ In the individual volumes, more details are given of how the resources will be spent by the SOEs, such as the programs, functions, and subfunctions they will invest in and the financial source for these expenditures. The information in the Investment Budget, however, includes mostly expenses that will be covered by the SOEs' own resources, and covers little of the activities of the largest SOEs. BNDES, for example, is listed in the volume only for expenses in the context of the program of "governance and maintenance of infrastructure of Federal SOEs," which involve their general administration and information technology. These expenses, covered with the bank's own resources, amount to US\$45 million. As another example, Petrobrás' global expenses in the Investment Budget are scattered –since it is not unified with its subsidiaries and affiliated or controlled companies. More expenditures are included in this volume for Petrobrás; other than the own company's infrastructure and administration, there are also "fuels," "electricity," "petroleum and gas," and "productive development," amounting to a total of US\$30.6 billion. These activities involve some of the ventures for the modernization and/or installation of new infrastructure, such as pipelines, refineries, and research centers.

The Year-End Report (*Prestação de Contas da Presidência da República*), as mentioned above, presents information on SOEs in different parts of the text than the Investment Budget, such as the section dedicated to IFFs that act as development or fomenting agencies, like BNDES, which is in the Fiscal and Social Security Budget.^{31, 32} For the latter, which will be detailed in this report when dealing specifically with BNDES, there is extensive information for each SOE regarding expenditures with funds from this budget and the agency's financing operation that do not include strictly monetary operations. As for the Investment Budget, it comprises a series of tables with extensive information on the SOEs' expenditures according to different criteria for data display, detailing the balances for the reference year (2010) and presenting comparisons for a five-year period (2006-2010). These expenditures appear reported 1) by governmental programs, 2) by supervising ministry or executive office, 3) by general investment area and subareas, 4) by the nature of the financial source for expenditures, 5) by SOE sector (SPE or IFF), 7) by specific SOE, and (8) by geographical region. The details include the resources initially pledged in official budget documents, the accessible credit, the available funds (sum of both pledge and credit), the actual expenditures, and the percentage of

³⁰ The whole Enacted Budget – law, volumes, and annexes – can be found in Ministry of Planning, Budget and Governance (MPOG), *Secretaria de Orçamento e Finanças (SOF), Orçamento Federal, Orçamentos Anuais*, available at <http://www.orcamentofederal.gov.br/orcamentos-anuais>

³¹ Part 4 of the *Prestação de Contas da Presidência da República*. 2010, available at: <http://www.cgu.gov.br/Publicacoes/PrestacaoContasPresidente/2010/Arquivos/PCPR2010.pdf>

³² Part 3.5 of the *Prestação de Contas da Presidência da República* for 2010.

resources that were executed.³³ The report also details the SOE activities that surpassed the available budget and dedicates a section in this chapter to share overall information on fomenting agencies, also comparing between the areas and geographical regions in which they invest, their financial sources, and the beneficiary's institutional capacity in accordance to their social capital and revenue.

In this way, the main reference for the report on the Investment Budget is the Enacted Budget, which authorized an initial budget of about US\$46 billion for 75 SOEs in 2010 and was adjusted during the year to reach over US\$50 billion for 78 SOEs (70 in SPE and 8 IFF). Of the total, only 79.4 percent of the total was spent, and the areas that had the highest rates of actual investments were national security, industry, and energy. In contrast, the transportation, communications, health, and administration areas used under 50 percent of their available budget. In terms of investment, these are concentrated greatly in the energy area (around 93 percent of the total investments). Over the comparison period (2006-2010), the sectors that grew the most in budget investments were industry and social security, while communications and agriculture grew the least. For financial sources, a table indicating in general the financial sources for the SOEs in the Investment Budget is presented, separating out: 1) their own resources, 2) resources to increase their liquid patrimony – that may come from the Treasury, the controlling company if any, or other SOEs, 3) long-term credit operations – both internal and external, 4) and other long-term sources, such as debentures or transfers from a controlling company. The report points to the increase in long-term internal credit operations rather than the use of their own revenue in 2009 and speculates that this was due to the 2008 economic crisis. It does not specify the form of transaction in these transfers, and it does not offer any conjectures for the period considered in the table – 2007 to 2011 – which presents interesting variations in financing sources during an international economic crisis. The regional distribution of these expenditures, according to the report, are concentrated in the Southeast, but transfers to states in the Center-West and Northeast areas grew the most over the last couple of years.

“Over the comparison period (2006-2010), the sectors that grew the most in budget investments were industry and social security, while communications and agriculture grew the least.”

Legislative and External Oversight

Other than editing laws, the legislative branch is also responsible for other checks and balances, such as the external control of Executive Budget and financial activities. This is carried out by means of key budget documentation and reports on their execution. According to the Constitution, this control belongs to congress and is to be exercised with the assistance of the Federal Court of Auditors (TCU), which is responsible for examining all budget documentation and execution and has the power to audit, inspect, and investigate any public entity from the direct or indirect administration and from legislative and judicial branches.³⁴ Among responsibilities that are part of this control is the review of the balances for everyone responsible for managing public funds, properties, and any other assets that belong to the direct and indirect administrations, including SOEs. Each year, the TCU emits a

³³ The possible areas for these investments are Administration, Agriculture, Commerce and Services, Communications, National Security, Energy, Industry, Social Security, Health, and Transportation.

³⁴ Article 71 da *Constituição Federal de 1988*.

report evaluating the government's Year-End Report on the budget, including the Investment Budget for SOEs, which is elaborated by DEST.³⁵

Along with the technical report, the TCU published an executive summary with more commentaries on their findings.³⁶ This is an important instrument for legislative, external, or social control over the government's bills. In the 2010 summary, the TCU points to an increase in the Liquid Public Sector Debt (DLSP) of approximately US\$58 billion, which meant that it reached a total of about US\$740 billion in 2010, but its representation for that year in the GDP showed a slight decrease (2.43 percent), going from 42.78 percent to 40.35 percent. The TCU comments:

"The increase in the Federal Government's intervention in economic activities, accumulating assets and liabilities, maintains the DLSP under control, but overloads the National Treasury's fiscal burden, represented by the difference between the SELIC rate when the government sells its bonds and the rate it receives from its financial institutions and development agencies. To exemplify, the interest rates paid for capitalization [through the emission of public security bonds] of the Treasury in medium-term for the funds transferred to the BNDES are between 10 percent and 12 percent, while the rates applied by the bank varies between 4 percent and 6 percent – for a total of R\$236.7 billion [about US\$116 billion], the difference results in an annual fiscal burden of approximately R\$14.2 billion to the Treasury. Another effect of the financial mechanisms of funds transfers from the National Treasury to the BNDES is the generation of revenue from dividends in that and the next fiscal years of the transfers, since there's a disparity between the cost paid by the bank to the Treasury for the funds received and the valorization of these titles and funds transferred to the bank."³⁷

In the resumed version of the 2011 audit, the TCU found formal improprieties – such as expenditures made by twelve SOEs during the year that were over the estimate in the Enacted Budget and actions that involve more than one large-scale project without the necessary details in accordance to the government's long-term program.³⁸ The TCU also found offshore enterprises that are indirectly controlled by Petrobrás, but do not appear in the Investment Budget's list of SOEs, as well as a lack of information on business transactions between SOEs and private corporations regarding indirect investments with substantial public subsidies.

Once published, the irregularities in the TCU's report led to questions in the Senate, where the Commission on Environment, Consumption, and Fiscal Control (CMA) has recently mobilized a public hearing to discuss these findings, but with as yet no defined date.³⁹ These findings are in

³⁵ *Prestação de Contas da Presidência da República*, available at <http://www.cgu.gov.br/Publicacoes/PrestacaoContasPresidente/2010/Sumario.asp>

³⁶ TCU. Executive Summary for 2010 (most recent on official website), available at http://portal2.tcu.gov.br/portal/page/portal/TCU/comunidades/contas/contas_governo/contas_10/Sumario%20Executivo.pdf

³⁷ TCU. Executive Summary for 2010, p. 3.

³⁸ TCU. Contas do Governo, Exercício de 2011, available at http://portal2.tcu.gov.br/portal/page/portal/TCU/Rio20/fichas/ptb_03_contas_do_governo.pdf

³⁹ "Senators want to discuss irregularities identified by the TCU in 2011," 6/11/2012, available at <http://www12.senado.gov.br/noticias/materias/2012/11/06/senadores-querem-discutir-irregularidades-identificadas-pelo-tcu-em-2011>

accordance with the suspicion over the government's budgetary practices regarding their manipulation of the "unpaid bills," the lack of transparency on the exact transfer of funds from one entity to another, and the confusing relationship between private and public sectors regarding financing of ventures and shareholding of enterprises, as well as lending and subsidizing practices by federal financial institutions with both SOE and private corporations.

Public Participation and Control

The Brazilian government's authoritarian tradition lasted until the late 1980s, when the current democratic period was inaugurated by the Constitution of 1988 and the direct presidential elections in 1989. Transparency on government and SOE budgets wasn't common practice, however, and the country slowly began to release the information held by the military regime in a struggle to survive the petroleum crisis and the end of the "economic miracle" of the 1970s. The democratization process also had priorities other than the budget: the urge to guarantee and fulfill basic political and social rights, from freedom of expression to housing, was more pressing at the time. Even so, the process slowly came around to the question of budgetary transparency, especially when the privatization of SOEs became institutionalized.

Legislative efforts to guarantee some level of public access to government documents were made throughout the 1990s, such as granting access to public documents in archives, but not specifying how this would be done, determining obligations and deadlines for information regarding judicial defense of rights, and regulating the right to information regarding public databases, among others.⁴⁰ These laws, however, were published alongside other laws that worked in the opposite direction, such as the Presidential Decrees n° 2.910/1998 and n° 4.553/2002, that created exceptions for secrecy and privacy that cover documents, acts, and procedures.

Definitive advances toward budget transparency and the sharing of data and statistics on public finances and expenditures were made through the approval of the Law for Public Access to Information in 2011 and its regulation in 2012, to which all SOEs are subject.⁴¹ This law pushes all public entities to promote voluntary budget and performance transparency and accountability by making clear and detailed information easily accessible. According to the new legal provisions, the information made available must contain, at least, important addresses, telephone numbers, and working hours; all registrations of transfer or investment of public resources; information on income and spending of funds; information on the hiring procedures and all other contracts; general data on policies, programs, actions, and projects of any sort; and answers to the most frequently asked questions from civil society.

The access to information cannot require any particular justification and is free, except for costs associated with reproduction of materials, in which case this expense would be charged.⁴² The way the law works is by demanding from each individual public entity both "active transparency" – such as the adaptation of their websites to the law's demands and offering the necessary forms, information, and links – and "passive transparency" – the creation of a service to attend inquiries from citizens and all necessary procedures to attend to requests in the given time period. The law clearly states that requests that are generic, disproportionate, or demand the interpretation, analysis,

⁴⁰ *Lei n° 8.159 de 1991; Lei n° 9.051 de 1995; and Lei n° 9.507 de 1997.*

⁴¹ *Lei n° 12.527 de 2011 (Lei de Acesso à Informação)*, available at http://www.planalto.gov.br/ccivil_03/_ato2011-2014/2011/lei/l12527.htm; and *Decreto n° 7.724 de 2012*, available at http://www.planalto.gov.br/ccivil_03/_ato2011-2014/2012/Decreto/D7724.htm

⁴² Article 14 of the *Decreto n° 7.724 de 2012* forbids the demand for motives, reasons, or justifications from inquirers when trying to access public information covered by this law.

or crunching of data that has not yet been done will not be filled. In the latter case, the entity being solicited is required to offer alternatives to the inquirer, such as access to the data so that the requester can interpret or analyze it in some other way. The general procedure when requests are received is each that entity has 20 days, which can be extended to a maximum of 10 additional days, to either: 1) send the information to the given physical or electronic address; 2) communicate the date, place, and time for the data consultation, the reproduction of materials, or the delivery of certificates; 3) communicate that they do not have the required information or have no knowledge of it; 4) indicate if there is knowledge but no possession of the information; or 5) indicate the reasons for total or partial denial of access. To partially or totally deny access to public information, the entity must present reasoning based on clear legal instruments, such as the document's classification as secret and why, as well as presenting the possibilities for appealing the denial.

At this point in the procedure, some of the flaws in the Law for Public Access to Information become clear, such as the absence of an independent entity or office solely or mostly dedicated to the law's observance and execution, which could accept requests for information and guarantee that they are answered adequately, as is done in Mexico, for example. In Brazil's case, it was determined that each public entity, through its highest executive office, should designate another office directly subordinated to it to: 1) ensure the observance of the law, 2) evaluate its execution by the entity, 3) recommend better procedures to attend to the law's and citizen's demands, and 4) respond to complaints, appeals, and special requests. If the entity's first response to the request is partially or totally negative, an internal appeal must be available within 10 days, and the administrative office in turn will have five days to respond. If denied again, the inquirer may appeal to the highest office within the entity – the previously mentioned designated office – which will, once more, have five days to answer. Moreover, if there is no response to the information request, the inquirer may appeal to the highest office. This provision takes effect if the entity fails to respond with 30 days.

The first centralized level of appeal comes when the highest office of each entity either continues to deny the request or remains unresponsive, in which cases the inquirer may appeal to the Office of the Comptroller-General (CGU), who will have five days to demand clarifications from the entity.⁴³ Finally, in case even the CGU denies the request, which, by then, must be due to its classification as secret for one of the legal reasons, the last level of appeal is the Commission of Reevaluation of Classified Information, the entity empowered to declassify information and open it to the public. Even so, the CGU is the central player in the law's application, since it has responsibility for developing general procedures and forms for requests and appeals, for promoting campaigns for transparency and public education, for training of public officials and civil servants, and for monitoring the observance of rules regarding use of forms and respect to deadlines. The CGU is also responsible for producing an annual report on the law's application and results, which will become a powerful instrument to assess the country's transparency.

Finally, the law also opens a loophole for SOEs that operate under competitive regimes not to disclose publicly a series of data, mostly financial and to which the market controlling entity – the CVM – has classified access, but which includes their general and high office payrolls. In this way, it is clear that the law's effectiveness will depend on some crucial factors: 1) the demand from society for information and transparency through the law's possibilities; 2) the CGU's performance as the main central entity for the law's respect and observance, as well as its evaluation and active participation in answering appeals and enforcing deadlines and request responses; 3) the compliance

⁴³ Decreto nº 7.724 de 2012. Articles 23 e 24.

of each individual entity or their negative classification in general and yearly evaluations by the CGU, and, if possible, the adoption of measures to improve practices that obstacle transparency.

Conclusions

The political foundation of contemporary Brazil state began with the Federal Constitution of 1988, with which a new social and economic order was to be built with the support of a democratic government and decentralized administration. Since the 1930s, Brazil had sustained “import substitution,” an aggressive state government-induced industrialization and development process under which authoritarian governments made large investments in basic industry, resource extraction (especially petroleum, gas, and iron), telecommunications, and energy production. Democracy came at the end of the 1980s, followed by a massive privatization campaign promoted by government.

Even so, the state SOEs remained significant to the country’s economy prosperity and development, although it is difficult to determine to what extent because of a lack of information on the sector’s expenditures, revenues, financial sources, and profit distributions. Public access to information, however, has been strengthened significantly over the past few years as a result of the demands of social movements and the recently published law. Transparency and accountability in the SOE sector are important instruments to help build an open budget and to enable social control over the use of public resources, since SOEs are both institutionally and economically tied to the state.

This study has covered the general aspects of the state ownership of enterprises: the legal framework, the available information regarding budget and activities, the external and legislative oversight, and the public participation allowed by the existing structures and procedures. Two main objectives governed this effort: first, the need to make a comparison with the guidelines put forward by the OECD in 2005 and second, to suggest questions on SOEs that IBP can possibly use in its Open Budget Questionnaire and Index (OBI). However, the research does not end there: to illustrate the complexity of the SOE sector in Brazil, two case studies are presented as separate appendices. The choice of SOEs wasn’t random, and the result of this choice is a only a brief demonstration of the intricate system of compensations between the quasi-fiscal activities undertaken by SOEs, their funding or subvention through public resources, their support of private interests, and their promotion of government public policies.

The Brazilian SOEs have legal and institutional frameworks and regulations for state ownership that are in line with many, but not all, OECD guidelines. Since Brazil has no specific state-ownership policy or statute, the Constitution governs, and there are clear efforts for maintaining equitable competition between SOEs and private-sector enterprises, in which the SOEs are not exempt from general laws and regulations related to their activities and must face the competition for access to financial aid and support, especially regarding state-owned financial institutions and enterprises. However, the reality of the situation is more complex as the relationships between productive SOEs and IFFs have been intense, although these public banks also finance substantially the national private conglomerates. In Brazil, the SOEs are prohibited from receiving any fiscal incentives or privileges that could not be extended to the rest of the private sector. There is, though, a strong debate under way about the apparent exclusion of all SOEs from the procedures for financial recuperation and bankruptcy in the private sector by the new regulating law of 2005. Since the Constitution is clear in its intent to keep the market competitive and equitable, most scholars and most jurisprudence on similar themes have indicated that the exclusion only applies to SOEs that perform essential public services. Thus, the total exclusion of SOEs by this legislation is either unconstitutional or should be applied only to the SOEs offering basic services. Moreover, free competition is not the reality in sectors such as oil and gas exploration and production. The OECD also mentions opening channels for stakeholders and competitors to address their claims of rights’

violations, as well as for creditors to press their claims in cases of insolvency. Brazil has also built little institutional dialogue between stakeholders or competitors and the SOEs, but recent advances in client relations' services and through the Law for Public Access to Information might change this reality.

As for the question of quasi-fiscal activities, based on the IMF's Manual on Budget Transparency (2007), Brazil shows clear indications that there might be a problem with its budgetary practices. The TCU report and comment on the transferring of funds between the National Treasury and the BNDES, a practice that generates a debt for the Treasury and dividends for BNDES, illustrates part of the scheme that allows the Brazilian government to simultaneously sustain large-scale investments through national banks and obtain a primary surplus in an adverse international economic scenario. According to the IMF's definitions, the BNDES performs a number of quasi-fiscal activities, such as loaning funds below market rates to privileged sectors, and participating as a central instrument in the masking of debts and investments in the government's budget, at the same time it has to follow specific requirements for employment and service hiring. In addition, the bank works within the government's policy of strengthening "national champions" to compete in international markets, including both SOEs, such as Petrobrás and Eletrobrás, and private companies, such as Vale. Meanwhile, all of the government's expenditures, from the transfers to the BNDES to its payroll and infrastructure constructions, are done within growing "unpaid bills".

One of the IMF's most recent assessments – "Brazil: Financial System Stability Assessment," published in June 2012 – has recently noted that the public sector's presence in the financial sector is significant, amounting to the control of over 40 percent of total banking assets by government-owned financial institutions. The assessment notes that during the crisis, three large federal government-owned banks – BB, Caixa, and BNDES – played a major role in the compensation of private investors and lenders during the financial crisis, while also sustaining the government's long-term plan of expanding access to finance and credit in support of development. In this way, the Treasury has been providing BNDES with funds so that the bank can expand its lines of credit, and the IMF's assessment estimates that altogether "the fiscal stimulus, including the quasi-fiscal operations of BNDES, amounted to 3 percent of GDP." The IMF report also says:

BNDES is a pillar of the Brazilian financial system and its mandate has evolved with developmental needs over the years. As the Brazilian economy grows, however, financing constraints will increasingly limit its capacity to remain the single financier of long-term investments. BNDES should now focus on supporting market-based financing by crowding in private sector intermediation, for instance by co-financing projects and securitize the proceeds, placing the securities with institutional investors. Also, BNDES should move away from direct financing of large corporations with market access (such as Petrobrás and Vale) towards helping to develop the long-term corporate debt market through standardization, market making, and signaling (through minority investments). Pricing should be actuarially fair (covering expected losses as well as administrative and funding costs), but this will require strengthening governance and transparency, as well enhanced supervisory oversight.

Petrobrás is another example of quasi-fiscal activities and their complexity within the Brazilian state. The SOW still maintains a practical monopoly on petroleum exploration and production in the country. It owns 11 of the 13 refineries, for example. Prices are controlled by government and maintained below their international competitors, which causes revenue loss and less competitiveness, since Petrobrás maintains businesses abroad. Meanwhile, the federal government

tries to extend all possible credit and tax facilitations to the company, which, though they are available to any company, are mostly granted to Petrobrás since it dominates the sector either directly or through its subsidiaries, affiliated or controlled companies, and corporations in which it holds significant amount of shares. In addition, the recent process of Petrobrás' capitalization further tightened the government's grip on the company, which alarmed minority shareholders and is a departure from the practices considered positive by entities such as OECD, IMF and IBP.

In general, an assessment of the SOE sector in Brazil will point to the existence of a coherent and institutionalized legal structure that allows considerable levels of organization and transparency regarding activities and budgets, although the available documents and demonstrations require levels of education that are not widespread in the country. The Constitution ensures liberal and competitive basis for the SOEs and laws regarding budget, fiscal responsibility, and transparency institute positive practices and procedures for their monitoring. A lack of centralization of all SOEs, however, does obstructs a holistic appreciation of the complex connections between SOEs, the government, and the private sector. In practice, government has increasingly used some key SOEs – such as BNDES and Petrobrás – as effective branches for executing programs and policies. In this context, transparency is of the essence, given the deep connections between the recurring positive primary balances, the rich investments in Petrobrás and through BNDES and a growing “parallel budget” of unpaid bills. Recent advances, such as the Law for Public Access to Information, may become powerful instruments to reassure citizens and investors that the federal government is acting responsibly with its bills.

Annex 1: Brazil's National Bank for Economic and Social Development – BNDES

The Brazilian Economic and Social Development Bank (BNDES) is the country's main financing agency for investment policies for both state programs and private ventures. It is owned exclusively by the federal government, which controls all of the bank's shares. Since its foundation in 1952, BNDES has stimulated the expansion of industry, exports, and infrastructure, and it has invested in technological innovation and in modernizing the public administration. Historically, however, the bank has assumed more roles than just extending financial support, contributing – through its technical and bureaucratic staff and qualified access to information on economic factors and agents – to shape Brazilian development. Until the 1990s, the bank sponsored the state strategy of import substitution, in which it developed the country's basic industry and infrastructure. This model, however, required too much state intervention and public efforts and was criticized strongly at the end of the 1980s.

At that moment, both the Brazilian government and the bank changed positions radically and began a process of privatization focused on the “competitive insertion” of Brazil into the global economy. These privatizations were done by groups of SOEs and with facilitated credit given by BNDES, which stimulated the conglomerates in the sectors of civil construction, agriculture, mining and extracting businesses, and energy production, among others. Today, BNDES continues to contribute in this process that now involves less of the privatization of state enterprises and more the formation of “national champions,” which involves strengthening the big private conglomerates in the commodities sector so they can compete with leading global enterprises. Officially, however, the goals of BNDES is to offer varying schemes of financial support to Brazilian private enterprises of all types and sizes, including those in the public sector and to promote its three declared principles – innovation, local development, and socio-environmental development – in all economic sectors.

The importance of BNDES as an economic actor is significant not only within Brazil, but also internationally. Compared to the annual disbursements of other development banks, such as the Inter-American Development Bank (IDB) and the World Bank's International Bank for Reconstruction and Development (IBRD), since 2007 BNDES has had expenditures at least twice the large as those for both banks combined. The media have pointed to the bank's growth and reported its disbursements in 2010: while BNDES invested US\$81 billion, IBRD invested US\$22 billion in 43 countries and IDB invested US\$8 billion) in 26 countries.⁴⁴ Meanwhile, scholars point to a longer period in which the BNDES had already surpassed the international banks, disbursing US\$33 billion in 2007, US\$50 billion in 2008 and US\$68 billion in 2009, while both the IDB and the IBRD combined invested just US\$18 billion in each of the first two referenced years and US\$30 billion in the last.⁴⁵

1. Institutional Framework and Governance

According to the statute establishing BNDES, its main operations are financial, and there are constant references to a broad spectrum of funds, resources, and credit that are available for development purposes, to be applied and invested by the bank in various sectors. BNDES can also offer other financing possibilities, some of which demand no return, which are referred to as “non-fundable applications” in their statute, in programs related to education and research, scientific or technological efforts (including hiring technical studies and making donations of materials and funds), and social projects that promote job creation, urban services, health, education, sports, justice,

⁴⁴ *O Globo*, “O gigantismo do BNDES,” available at <http://oglobo.globo.com/infograficos/gigantismo-bndes/>

⁴⁵ João Roberto Lopes, “Introdução,” *Ambientalização dos Bancos e Financeirização da Natureza*. Brasília: Rede Brasil sobre Instituições Financeiras Multilaterais, 2012), p. 13.

housing, the environment, rural development, and culture, among other areas.⁴⁶ Any investment or financial collaboration made by BNDES must obey a set of rules that involve 1) technical and financial assessment of the venture, project, or business plan, including social and environmental implications; 2) verification of the refund security, except if not needed by legal determination; and 3) and evaluation of the morality of the entrepreneurs or the enterprise.

Supervised by the Ministry of Development, Industry, and Foreign Trade, BNDES' organizational structure has as its highest governing body an administrative council, composed of 10 members of the government, among them the council's president, of which six will be appointed by the supervising ministry and one each by the Ministry of Planning, Budget, and Governance (MPOG), the Ministry of Labor, the Ministry of Finance, and the Ministry of External Relations.⁴⁷ The current composition of the administrative council also includes two seats for representatives of major employers and two seats for major workers' representatives. The members from government are all appointed by the President of the Republic, judged by criteria established in the statute, among them knowledge and experience, as well as high morality and untainted reputation. The member representing the workers is also appointed by the President and must have a substitute in case of absence. All the members' terms are for three years, with the possibility one extension, but once a term expires, they must continue to occupy the position until a new member is appointed.⁴⁸ The council's duties, as listed in the statute, include, among other things, to deliberate, examine, and approve the President's vetoes and decisions regarding the bank's orientations for investment and action, as well as their specific governance and budget-related plans, and to deliberate on the creation, mergers, acquisitions, and extinction of subsidiaries. The council usually meets every trimester of the year but may do so extraordinarily in case the President demands or by solicitation of at least two members.

The board of directors is composed of the President, the Vice-President, and six directors with no specific designation, all appointed by the President of the Republic and subject to immediate dismissal. The President and the Vice-President have indefinite terms, while each director has a three-year term with the possibility of one reelection. In terms of budget, the board of directors must evaluate and submit to the administrative council the expenditure program and the management budget for the bank and comment on the trimestral financial reports, also submitted to the administrative council. Effectively, the board of directors runs BNDES, authorizing agreements and contracts; authorizing all hiring of construction and services; authorizing all acquisitions, sales, and donations of bank assets and nonrefundable investments; and approving the internal organization of the bank, the distribution of attributions and the creation of subsidiaries, offices, and agencies.⁴⁹ Some of these decisions, however, such as alienation of assets and creation of subsidiaries, must be previously sanctioned by the Ministry of Finance. The board of directors meets weekly or if the President demands a meeting or at least five board members request one.

BNDES also has in its structure both a fiscal council and an internal auditing committee, which have different duties and compositions. The fiscal council's main duty is to examine and assess the financial and budget declarations and balances; the council has the power to demand official disclosure on budget execution of any office in the bank, as well as minutes of meetings and other

⁴⁶ Estatuto do BNDES. Article 9, IV and V, available at:

http://www.bndes.gov.br/SiteBNDES/bndes/bndes_pt/Institucional/O_BNDES/Legislacao/estatuto_bndes.html

⁴⁷ Ministério do Desenvolvimento, Indústria e Comércio Exterior, available at: <http://www.desenvolvimento.gov.br/sitio/>

⁴⁸ Estatuto do BNDES. Article 11, available at:

http://www.bndes.gov.br/SiteBNDES/bndes/bndes_pt/Institucional/O_BNDES/Legislacao/estatuto_bndes.html

⁴⁹ Article 15 of BNDES' Statute.

deliberations that involve the bank's finances. Other functions may be assumed if demanded by the Law for Open-Capital Corporations, to which the bank is subject as a public financial institution. For example, members of the fiscal council would be permitted to attend meetings of the administration council or board of directors in which there will be deliberation on matters subject to the fiscal council's appreciation.⁵⁰ BNDES' statute, however, does not establish any effective measures that can be taken by the fiscal council in case of resource mishandling or budget irregularities. In addition, there are no accountability measures or provisions in the statute regarding the high administrators' and council members' work ethics and professional performance. Two of the three members of the fiscal council are from the Ministry of Development, Industry and Foreign Trade and one by the Ministry of Finance, and are appointed by the President of Brazil. They are not subject to any other office in the bank.

As for the internal auditing committee, its members are chosen by the administrative council to which this committee reports, according to ground rules determined by the National Monetary Counsel (CMN). The committee's duties are to recommend to the bank's administration an external auditor to be hired; to revise, before publication, the semester's financial demonstrations; to evaluate the effectiveness of independent and internal audits performed on the bank; to recommend to the board of directors any improvements and changes in policies, practices, and procedures whose flaws or deficiencies were identified in the committee's exercise of its attributions; and to elaborate a report with information on its own activities and evaluation of the effectiveness of the internal control systems.

BNDES has slowly become more than just a bank; it has developed into a system that comprises three other public enterprises and business corporations, one of which acts mostly internationally. According to the bank, the total assets of the BNDES System amounted to R\$625 billion in 2011. The first subsidiary to be created was FINAME, in 1966, with the objective of managing a fund for financing the acquisition of new industrial machinery and equipment. Although under BNDES jurisdiction and working with its collaboration, the management of this agency is done almost autonomously by the members of its administrative council, who are responsible for using the available funds to finance the production and export of national machinery, as well as the import of and payment for similar equipment from abroad. The main objectives of FINAME are to attend to the growing commercial production of national machinery, to finance the import and export of such equipment, and to aid in the expansion of Brazil's production of industrial apparatus.

The second enterprise, BNDESPAR, is a business corporation whose capital stock is divided in shares, but is an integral subsidiary of the bank. As the only shareholder, BNDES controls this holding and runs it through an appointed administrative council, a board of directors, and a fiscal council. BNDESPAR's official role is to capitalize operations for undertakings controlled by the private sector in accordance to the bank's policies and principles; to support enterprises that are efficient economically, technologically, and administratively, with good chances of investment payoffs; and to administer shares and contribute to the strengthening of the stock market by promoting more democratic ownership of corporate capital.

The final enterprise, BNDES Ltd., is also an integral subsidiary of the bank, created in London with the main purpose of acquiring shares in other enterprises and working as an investment company. Created in 2009, this subsidiary represents BNDES's debut in one of the world's most important financial centers and marks definitively the movement toward the internationalization of Brazilian

⁵⁰ Lei das S.A. nº 6.404 de 1976, available at http://www.planalto.gov.br/ccivil_03/leis/L6404consol.htm; and Lei das S.A. nº 6.404 de 1976. Article 163, §3º.

enterprises. Of all three components of the BNDES system, BNDES Ltd. is by far the subsidiary on which there is less information available both in budget documents and in the bank's website and reports, although it is subject to the Law for Public Access to Information. Both BNDES Ltd. and the law, however, are recent developments, and the latter has yet to be applied successfully to obtain more detailed information in this bank's London subsidiary. For example, there is no legal statute or internal regulation for this subsidiary on BNDES' website.⁵¹

More recently, BNDES created two important accountability offices that cover the whole BNDES system: the auditing committee, included in the bank's statute in 2004 and a client relations service in 2007. The auditing committee, among other duties, produced every semester a report containing assessments on 1) its own activities; 2) the effectiveness of the BNDES system's internal control procedures; 3) the recommendations made to the BNDES board of directors, pointing out the ones that were not accepted and why; 4) the internal and independent audits of the BNDES system; and 5) the quality of budget information and the observance of Brazil's Central Bank financial norms, applicable to all financial institutions, both private and public.

The committee is composed of six members, who are appointed and may be dismissed by the bank's administrative council and are given indefinite terms. These committee members may also occupy seats on the administrative council of the bank or on other councils. In its turn, the client relations service is an institutional communication channel between the enterprises that compose the BNDES system and their clients; it is dedicated to conflict mediation and the formal treatment of client complaints. Other duties include proposing corrective measures and improvements regarding their procedures and routines to the high administration of the BNDES system. These propositions are contained in the report produced every semester that includes both quantitative and qualitative information on the client relations service's performance, which is submitted to the internal auditors, the audit committee, the board of directors, and the administrative council. The head of the client relations service is appointed and dismissed by the president of BNDES, also for an indefinite term.

2. Performance and Investment Options

The election of former President Luiz Inácio Lula da Silva in 2002, marked the definitive role of BNDES in the government's plans of inducing the emergence of "national champions" to compete with other global leading private corporations. The success of this effort can be observed in the list of the bank's main credit beneficiaries, such as the banks Bradesco and Itaú-Unibanco, the civil construction enterprises Odebrecht and Andrade Gutierrez, the cellulose producer Vorotantin-Aracruz, the mining industry Vale, and other large-scale corporations like Ultrapar, Queiroz Galvão, Camargo Correa, Grupo EBX, Gerdau, and Perdigão-Sadia. The privileging of these conglomerates through credit lines and financing schemes sparked questions about the lack of publicity on the criteria that guide the bank's decision process and the fact that the beneficiaries all could have capitalized within the private credit and stock markets. In addition, BNDES controls important board positions or holds large numbers of shares in many of these enterprises.

In turn, BNDES has also become a "national champion" in its own right, surpassing investments made by similar international banks and acting as one of the largest financing and fomenting agencies in the country. The bank's available funds have four major sources: 1) transfers from the Workers' Support Fund (FAT), whose objective is to finance activities that create jobs and revenue and qualify the workforce, 2) payments of their conceded credit and financing schemes, 3) profits from their applications and shareholding participations, and 4) transfers from the National Treasury.

⁵¹ Legislation of the BNDES System, available at http://www.bndes.gov.br/SiteBNDES/bndes/bndes_pt/Institucional/O_BNDES/Legislacao/index.html

Historically, the funds from FAT have been the major stable revenue source for the bank, as noted in BNDES' report on its own 2011 activities, FAT has dedicated 40 percent of its funds to the bank's activities (the other 60 percent funds unemployment insurance and salary bonuses and allowances).⁵² In 2011, US\$7 billion from FAT went to BNDES, which represents a lower figure than in previous years and can be explained by the growing transfers from the National Treasury's since 2008. According to a summary of revenue sources of the bank in 2011, FAT made up 39.5 percent of the bank's funds in 2009, 29.7 percent in 2010, and 28.5 percent in 2011; meanwhile, the National Treasury funds increased from 37.3 percent in 2009, to 46.1 percent in 2010, and 49.7 percent in 2011.⁵³ In the Bank's trimestral report of January 2012, from 2008 to 2011 the Treasury's transfers reached over US\$115 billion in the form of the issuing of public debt bonds.⁵⁴

Another example of these transfers by the Treasury is the Law n° 12.453 of 2011, which updated its preceding laws, and in the 1st article, allows the state to concede "economic subventions through the equalization of interest rates in operations contracted" until June 2012 for the purchase and production of capital goods in the energy sector, including technological components and services and export structures and products through BNDES, in the amount of R\$208 billion (US\$100 billion). This "equalization of interest rates" corresponds to the difference between the final borrower's burden, and the cost paid at the source of the funds, plus the revenue made through this investment by the BNDES or the financial agent in the transaction. In addition, the 2nd article authorizes a credit line from the Treasury to BNDES in the amount of R\$100 billion (US\$48 billion), to be covered by the issuing of public debt or security bonds, under long-term interest rates.

This arrangement recently incited members of the congressional opposition to include in the 2012 Pre-Budget Statement a legal obligation for the Executive to declare its plans for issuing public debt bonds for BNDES' capitalization in the Enacted Budget. The President of the Republic, however, vetoed the legislative demand, and this will definitely reduce the transparency and accountability of the bank, guaranteeing that government can maintain freely a "parallel" budget over which there is little control by Congress and society.

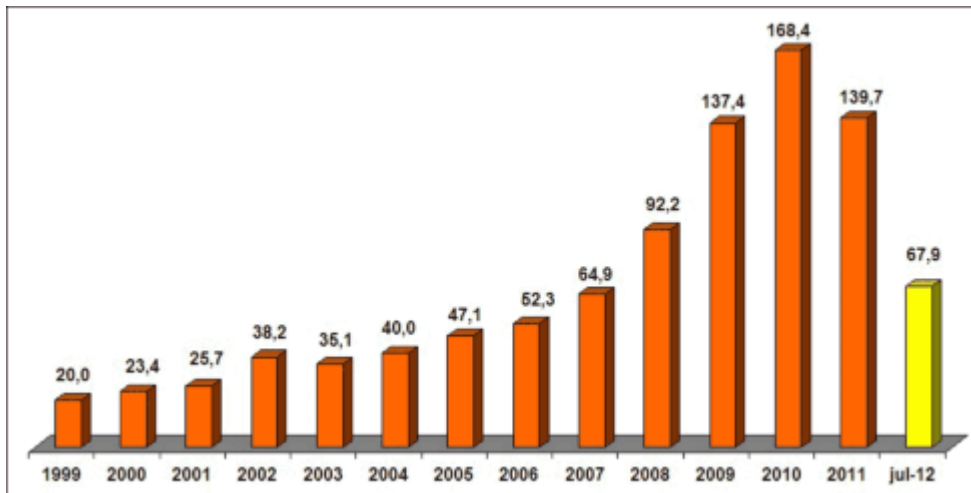
Since its nature is to foment economic and social development, the bank's strongest performance indicator has always been its disbursements, and these have grown consistently since 1999, as shown in the graph below.

⁵² BNDES, Relatório de Gestão do Exercício de 2011, available at www.bndes.gov.br/SiteBNDES/export/sites/default/bndes_pt/Galerias/Arquivos/empresa/download/2011_Relat_Gestao_BNDES_BPAR_FINAME.pdf

⁵³ BNDES, Relatório Anual 2011, Revenue Sources, available at http://www.bndes.gov.br/SiteBNDES/bndes/bndes_pt/Hotsites/Relatorio_Anual_2011/Capitulos/o_bndes_em_numeros/desempenho_economico_financeiro/fontes_de_recursos.html

⁵⁴ Relatório Trimestral Gerencial do BNDES, January 2012 available at http://www.bndes.gov.br/SiteBNDES/export/sites/default/bndes_pt/Galerias/Arquivos/empresa/download/Relatorio_Recursos_Financeiros_1trimestre2012.pdf

Graph: BNDES Annual Disbursements in R\$ Billion – 1999 thru 2012⁵⁵



Source: BNDES,

http://www.bndes.gov.br/SiteBNDES/bndes/bndes_en/Institucional/The_BNDES_in_Numbers/

The significant and obvious increase in investments as of 2008 coincides with the latest international economic crisis and the launching of several large-scale government programs, such as the Program for Accelerated Growth (PAC), in which the emphasis is on infrastructure and civil construction, and the Program for Sustained Investment (PSI), in which production, acquisition, and export of capital assets and technological innovation are stimulated. Both programs have the bank's active participation. While most of the bank's information and indicators focus on the increasing disbursements, it is important to note that this indicator should not be considered a measure of the bank's success, since reflects no qualitative judgment of impact on economic or social development.

In the BNDES report on its 2011 activities, there is an overview of the major programs and projects in which the bank is involved. We will mention in more detail the *Programa de Aceleração de Crescimento – PAC* (Growth Acceleration Program), the *Program de Sustentação de Investimento – PSI* ("Program for Sustained Investment") and the *Cartão BNDES* ("BNDES Card").⁵⁶ First, regarding the bank's 2011 participation in PAC, the report points to the consolidation of a potential portfolio of 503 shared projects, for which BNDES has already approved the investment of US\$86 billion that can expand to US\$158 billion. This portfolio expresses the bank's emphasis on large-scale investments and the concentration of transfers to the already enormous energy production sector. Of the potential total investment of US\$158 billion in the 503 projects, some US\$125 billion and 310 projects are destined to this sector. As for the PSI, from its creation in mid-2009 to its scheduled end at the end of 2011 (though it was extended to the end of 2012) a total of US\$62 billion was spent, of which 80 percent was destined to the acquisition of capital goods by domestic corporations of all sizes.

Finally, the program *Cartão BNDES* is dedicated to financing – like a credit card – the purchase of and investment in specific products by accredited suppliers by micro, small, and medium enterprises in a simplified manner. Among the ways to judge this program are such indicators as the number of cards issued, the range of municipalities where the program has a presence, and the disbursements

⁵⁵ The values are in Brazilian Reals, but can be grossly converted into American dollars if divided by two.

⁵⁶ BNDES, Relatório de Gestão do Exercício de 2011, p. 41, available at www.bndes.gov.br/SiteBNDES/export/sites/default/bndes_pt/Galerias/Arquivos/empresa/download/2011_Relat_Gestao_BNDES_BPAR_FINAME.pdf

made by the bank. Up until the end of 2011, when the report was published, “around 472 thousand cards [were] actively valid and amounting to over R\$24 billion [US\$12 billion] in credits already conceded for purchases and investments.”⁵⁷ These cards have been issued in over five thousand of Brazil’s municipalities, representing 92.7 percent of the total in the country. Of these, over 87 percent have already used the cards effectively. In that year, US\$3.7 billion was disbursed by the bank in operations done through the *Cartão BNDES*, which is a significant increase from the US\$2 billion disbursed in 2010.

The bank is also involved with the financing of sporting events, such as World Cup in 2014, and, according to the referred annual report issued by the bank (2011), two major programs are being developed. The *BNDES ProCopa Turismo* – to last from January 2010 thru December 2012 – dedicated to transferring approximately US\$485 million to the construction, reform, and amplification of the national hotel network, with financing schemes that can reach 12 to 18 years to return and with investment limits, for the bank, of 100 percent in case of ventures by small or medium enterprises and of 80 percent in case of ventures by large-scale corporations. In 2011, four projects were approved to receive financing from BNDES, and they amounted to a disbursement of US\$22 million. Second, the *BNDES ProCopa Arenas* – to last the same period as the previous program – dedicated to transferring approximately US\$2.3 billion to the construction and renovation of the stadiums that will host games during the World Cup and to the urban renewal of their surroundings. In this program, the limits are established: the bank can invest up to 75 percent of the total cost of the venture, with a cap of US\$193 million per project, including the stadium and its surroundings. In 2011, four projects were approved to receive the Bank’s investments, none of which are specified in this report, but that amounted to US\$379 million.

The bank’s investments are not very well distributed between sectors. The emphasis has been on industry and infrastructure, which each take up around 30 percent of the funds destined for in mechanical, metallurgic, chemical, and petrochemical industries, also backed by FINAME’s performance, and in construction, electricity, and rail transportation. Reducing inequalities among the Brazilian regions and funding large-scale ventures and enterprises have been emphasized to the detriment of small and medium-sized businesses are recurrent in BNDES policies.

According to the bank’s operational statistics, disbursements by region in the period of 2002 thru 2011 have always been concentrated in the Southeast region of the country, where the major cities of São Paulo, Rio de Janeiro, and Belo Horizonte are located. In 2002, the Southeast represented over 60 percent (US\$11 billion) of the investments, while in 2011 the percentage fell to a little under 50 percent (US\$33 billion). However, the structure of investments by region was maintained. The South continues as the second-largest beneficiary, while the Center-West and the North have slimmer shares of funds. For example, the South went from US\$2.9 billion or 16 percent in 2002 to US\$14.3 billion or 21 percent in 2011, and the North went from US\$5.2 billion or 5 percent, to US\$5.2 billion or 8 percent.⁵⁸

As for the size of the enterprises in which the bank invests, large-scale corporations have been historically the primary beneficiaries, although the participation of micro, small, and medium enterprises (MPME) has grown significantly since 2002. In that year, US\$4 billion was destined to

⁵⁷ Ibid., p. 38, available at www.bndes.gov.br/SiteBNDES/export/sites/default/bndes_pt/Galerias/Arquivos/empresa/download/2011_Relat_Gestao_BNDES_BPAR_FINAME.pdf

⁵⁸ BNDES, BNDES Transparente, Estatísticas Operacionais, Região. Annual, available at http://www.bndes.gov.br/SiteBNDES/bndes/bndes_pt/Institucional/BNDES_Transparente/Estatisticas_Operacionais/regiao.html

these smaller enterprises, of which half was for micro-entrepreneurs or enterprises, representing 21 percent, while US\$14 billion, or 78 percent, went to large-scale companies. In 2010, the resources destined to MPME amounted to US\$21.9 billion, or 27 percent, while large-scale enterprises retained US\$56.8 billion, or 70 percent. The data for 2011, however, show a retreat from investments in large-scale companies, which only amount to US\$38.4 billion, while the funds for MPME remained stable at US\$23.9 billion, but reached 34 percent of the total investments.⁵⁹

This means that the vast majority of BNDES activities are related to stable and prosperous corporations and sectors, among which are the private “national champions” and several SOEs in the SPE sector, such as Petrobrás and its subsidiaries. Recent information published by the bank indicate that a credit line of US\$12 billion was established with Petrobrás to finance its investment plan for three subsidiaries in the 2009-2010 period, which the bank financed through the National Treasury, with public debt bonds.⁶⁰

The net worth of BNDES amounted to US\$30 billion in 2011, and it has surpassed the previous years’ standards in Referential Equity – an indicator used by national Central Bank to measure an institution’s financing possibilities. Other indexes, such as the adequacy of capital or Basel index, show that the BNDES system adopts defensive financial measures, holding 20.6 percent of the equity for every R\$100 financed, which is well above the 11 percent required by the Central Bank. The BNDES credit portfolio has amounted over US\$198 billion in 2011, representing around 20 percent of all the credit supply in the National Financial System (SFN). Of these, over 80 percent are considered long-term credit transactions and medium or low-risk investments.

The bank has participated in the internationalization of Brazilian companies, particularly in Latin America, the Caribbean, and Portuguese-speaking Africa, through the creation of aggressive institutional and financial mechanisms to enable increases in investment from these companies. Since 2002, the bank has been financing projects outside of Brazil if they hired services or purchased assets from national corporations, building an international portfolio of approximately US\$13 billion in 2010. The bank itself is ever more international, opening offices around the world, such as an office in Montevideo and the London subsidiary, BNDES Ltd. In 2011, the government authorized the bank to sponsor the acquisition and merger of Brazilian conglomerates outside the country, while also negotiating a cooperation agreement with representatives of the BRICS to facilitate common transactions and to formulate an institutional framework to provide funds and credit to common projects, possibly creating an international operating entity in the future.

3. Transparency and Oversight

BNDES is an IFF that has been defined by its own statute as “the main instrument for the execution of the Federal Government’s investment policy, with the primordial objective of supporting programs, projects, constructions and services related to the country’s social and economic development.”⁶¹ As such, transparency is the central tool for the assessment of the success of the state’s investment policy, and it is also essential for the construction of complex and accurate indicators for Brazil’s development. The role expected for BNDES in broader legislation, according to the Pluri-Annual

⁵⁹ BNDES. BNDES Transparente. Estatísticas Operacionais, Porte de Empresa, Annual, available at http://www.bndes.gov.br/SiteBNDES/bndes/bndes_pt/Institucional/BNDES_Transparente/Estatisticas_Operacionais/regiao.html

⁶⁰ BNDES, Sala de Imprensa, “BNDES e Petrobras assinam contrato de R\$25 bilhões,” 30 July 2009, available at http://www.bndes.gov.br/SiteBNDES/bndes/bndes_pt/Institucional/Sala_de_Imprensa/Noticias/2009/Industria/20090730_petrobras.html

⁶¹ BNDES, Statute. Article 3, available at http://www.bndes.gov.br/SiteBNDES/bndes/bndes_pt/Institucional/O_BNDES/Legislacao/estatuto_bndes.html

Plans (PPA), is to finance the PPA programs with the objective of reaching the established goals in those that fall under the bank's responsibility, through direct and indirect operations and activities by the accredited financial agents. For the period 2008-2011, the PPA's development strategy, in theory, gave priority to public policies that aimed to promote wealth distribution; to improve the educational system; to increase productivity and competitiveness; to expand markets for mass consumption; to explore resources in sustainable ways; to improve infrastructure, including urban and especially metropolitan; to reduce regional inequalities; and to strengthen democracy and citizenship.

More specifically, BNDES is also mentioned in the Pre-Budget Statement, when it deals with the state's policy for using funds to finance and stimulate agencies, which also include the Bank of Brazil (*Banco do Brasil – BB*) and Caixa Econômica Federal (*CEF*). In the past two Pre-Budget Statements (2011 and 2012), the priorities established for BNDES were basically the same and are by far the most extensive ones in this section (when compared to the other agencies mentioned).⁶² Among them, we mention the following here because they represent investment options that the bank does not make or makes with little dedication: the development of productive cooperatives of micro, small, and medium-size companies, with the goal of increasing by 50 percent the bank's investment in this area in relation to the past three years, if demand is properly presented; the financing and complementing of costs in the areas of public health, education, the environment (including the prevention, reduction, and remediation of desertification), infrastructure, (including mobility and urban transportation, coastline navigation, and expansion of the urban pipeline networks for gas distribution), and other public sector projects; financing the support of the expansion and development of solidary economy and enterprises, of local productive arrangements and cooperatives, as well as projects and ventures promoted by Afro-Brazilian and Indigenous groups; and the financing of job and revenue creation by means of microcredit, emphasizing projects and ventures lead by Afro-Brazilian, Indigenous, or female groups.

Other than priorities, the Pre-Budget statement also establishes some conditions and obligations for the IFFs, such as situations in which they cannot extend or renew any type of financing or credit lines, the content of annual reports, evaluations on the impact of their credit operations in the reduction of inequalities and unemployment, and the up-to-date availability of this information on the Internet.⁶³ It is interesting to note that of the four situations where financing by IFFs is not allowed, one does not apply specifically to BNDES, and the others represent a technical choice that allows IFFs to continue to finance ventures that are causing or corporations that have caused social and/or environmental damage. The first situation does not allow public financing for the acquisition of public assets included in the National Plan for Privatization (PND), created back in 1990 and amended to fit contemporary objectives.⁶⁴ It was through the PND, for example, that the state transferred its remaining shares in the privatized *Companhia Vale do Rio Doce* (Vale) to BNDES, to be used by the bank to extend credit for the restructuring of the economy (at the time opening to global markets and investors) through the private sector. In the Pre-Budget statement, however, BNDES is allowed, in exceptional cases, to finance the buyer in a privatization process if authorized by a specific law.⁶⁵ The second situation prohibits IFFs from lending to or financing institutions whose directors have been convicted of moral or sexual harassment, racism, child or slave labor, and/or crimes against the environment. The choice for basing the prohibition on a judicial conviction of individual directors for these crimes is extremely ineffective in avoiding social and environmental

⁶² LDO 2011, Lei nº 12.309, de 2010. Article 89, IV. LDO 2012. Lei nº 12.465 de 2011. Article 86, IV.

⁶³ LDO 2012. Lei nº 12.465 de 2011. Article 86, §§1º e 5º.

⁶⁴ Lei nº 9.491 de 1990. Articles 26 e 27.

⁶⁵ Pre-Budget statement, 2012. Lei nº 12.465 de 2011. Article 86, §2º.

damages caused by ventures or enterprises financed by IFFs. Its ineffectiveness is multifold: not only do these crimes require material proof for a conviction, but they also are individual offenses that involve the individual directors and not the companies' policies or practices. What's more, the judicial system is too slow and inadequate to respond to potential or actual social and environmental damages that are being financially supported by public funds through IFFs.

The bank itself also has its own legislation – the Statute and other norms⁶⁶ – and has, since 2008, increasingly offered important information on its activities, disbursements, and investment options, through Mid-Year Reviews and Year End Reports or reports on different aspects of the bank's activities, such as a trimestral report on the application of funds obtained through transfers from the National Treasury (“*Aplicação dos Recursos Financeiros Captados junto ao Tesouro Nacional*”) and an annual aggregated report (*Relatório de Gestão do Exercício de 2011*), which includes the subsidiaries BNDESPAR and FINAME, but not BNDES Ltd. These reports are all under the tab of “BNDES Transparent” (*BNDES Transparente*), launched by the bank in 2009, to share information on BNDES' operations, public accounts, administered funds, social and environmental responsibility, ethical governance, descriptions of the financial sources, financial resource applications, operational statistics, and so on.^{67, 68}

With regard to the application of the funds obtained through the National Treasury, the report is extensive, but covers primarily the evolution of these funds since 2009 and all the legal instruments that allowed the transfers in public debt bonds, such as the Provisional Measures (*Medidas Provisórias – MP*) and the laws that validated them. A table is presented with all the seven MPs (up until 06/21/2012), their interest rates, and the total amounts obtained and, therefore, owed. These amount to over US\$120 billion, and their application is described in the next section of the report.⁶⁹ According to another table, the portfolio of projects selected to receive the funds is composed of 47.6 percent transfers through FINAME, which means they support operations of production and commercialization of new machinery and equipment produced nationally, through indirect accredited financial institutions – and 20.1 percent through FINEM – which includes the large-scale investment projects in which the bank invests directly or indirectly with values over US\$4.8 million in ventures that intend to implant, expand, modernize, or recuperate fixed assets in the industry, commerce, service, agriculture, and cattle-raising sectors.⁷⁰ The report does not specify exactly the final beneficiaries of the funds and the amounts loaned, although it does briefly mention the major corporations and activities that received the funds, with no numbers presented.⁷¹ The only figures regarding the destination of these funds are presented for the investments contained in the Growth Acceleration Program (PAC), which amount to around US\$18 billion of the total funds disbursed by BNDES during the period between 2009 and 2012. Through PAC, Petrobrás alone got US\$5 billion

⁶⁶ BNDES System Legislation, available at: http://www.bndes.gov.br/SiteBNDES/bndes/bndes_pt/Institucional/O_BNDES/Legislacao/

⁶⁷ BNDES, Relatório de Gestão do Exercício de 2011, available at: www.bndes.gov.br/SiteBNDES/export/sites/default/bndes_pt/Galerias/Arquivos/empresa/download/2011_Relat_Gestao_BNDES_BPAR_FINAME.pdf, in “Annual Balance Publications,” http://www.bndes.gov.br/SiteBNDES/bndes/bndes_pt/Institucional/BNDES_Transparente/Processos_de_Contas_Anuais/

⁶⁸ BNDES, Relatório de Gestão do Exercício de 2011, p. 41, available at www.bndes.gov.br/SiteBNDES/export/sites/default/bndes_pt/Galerias/Arquivos/empresa/download/2011_Relat_Gestao_BNDES_BPAR_FINAME.pdf

⁶⁹ BNDES, Relatório Gerencial Trimestral dos Recursos do Tesouro Nacional. 3º Trimestre de 2012, October 2012, available at www.bndes.gov.br/SiteBNDES/export/sites/default/bndes_pt/Galerias/Arquivos/empresa/download/Relatorio_Recursos_Financeiros_3trimestre2012.pdf. See Table IV, p. 12.

⁷⁰ Ibid., See Table V, p. 13.

⁷¹ Ibid., pp. 23-32.

during this period, and the second largest beneficiary is its new refinery, Abreu e Lima S.A., as part of an industrial-port complex in Northeastern Brazil, which received US\$4.7 billion.⁷²

The improvement in transparency practices by the bank, still contrasts, however, with incidents in which BNDES refused to disclose information, especially regarding indirect investments made abroad – based on the argument of banking secrecy.⁷³ Regarding projects or enterprises outside of Brazil, there is nearly no information accessible to the general public other than aggregated values of contracts organized by country, but as the bank puts it, “Direct operations in the Foreign Trade sector, done through extension of credit or financing of foreign public entities with the objective of enabling the export of Brazilian goods and services, international contracts subject to confidentiality clauses and commercial secrecy.”⁷⁴

Regarding governance practices, the bank must adopt public principles like all SOEs, and its corporate management is controlled and examined by its own fiscal council and by the Federal Court of Auditors (TCU), the Brazilian external audit entity, and the General Comptroller Office (CGU), the country’s internal auditing office. It is relevant to note that the TCU has the power to initiate actual legal procedures if any improprieties are proven, while the CGU has no actual enforcement authority. The Year-End Report published by the government examines BNDES in two separate places: first, in the Fiscal and Social Security Budget, together with the other public investment agencies, where the report details the bank’s corporate plan for the next five years and the expenditures made with resources from this budget area; and second, in the investment budget, alongside other SOEs and among the IFFs. Regarding the first reference to BNDES, the balances for expenditures with contracts and transfers are presented by region and investment area, followed by a written evaluation of the bank’s allocations. In the investment budget, the information is displayed in a more aggregated and comparative manner, and BNDES is directly mentioned only when the balance is broken out by SOE and sector. The table below, from the investment budget of 2010’s Year-End Report, illustrates how much the bank has grown in significance over the past five years, surpassing other IFFs, such as Basa and BNB, to become the third-largest SOE in the sector. It is important to note that these values, however, do not include the bank’s whole portfolio or expenditures, but only the part of their executed expenditures related to funds from the government’s investment budget.

⁷² See Graph XVIII and comments in pg. 22. BNDES. Relatório Gerencial Trimestral dos Recursos do Tesouro Nacional. 3º Trimestre de 2012. Published October 2012.

⁷³ “BNDES resists auditing from the General Comptrollers Office (CGU),” available at <http://m.estadao.com.br/noticias/impresso,bndes-resiste-a-auditoria-da-cgu,456259.htm>

⁷⁴ BNDES, Contratações por país, Janeiro a dezembro 2009, available at http://www.bndes.gov.br/SiteBNDES/export/sites/default/bndes_pt/Galerias/Arquivos/consultas/ProjetosAEX2009.pdf

Table: Executed investment budget by SOE between 2006 and 2010 in R\$ thousands⁷⁵

Corporations	2006		2007		2008		2009		2010	
	Value (R\$ thousand)	%	Value (R\$ thousand)	%	Value (R\$ thousand)	%	Value (R\$ thousand)	%	Value (R\$ thousand)	%
BB	442.180	42.8	688.574	61.8	1.148.253	67.9	1.349.439	67.0	1.770.674	71.9
CEF	480.360	44.3	337.594	30.3	438.023	25.9	462.342	22.9	584.621	23.7
BNDES	9.455	0.9	7.967	0.7	37.816	2.2	17.408	0.9	52.873	2.1
BNB	33.331	3.2	32.090	2.9	14.356	0.8	37.471	1.9	21.142	0.9
Basa	70.377	6.8	25.959	2.3	15.184	0.9	5.589	0.3	19.353	0.8
IRB-Brasil RE	9.152	0.9	7.404	0.7	11.908	0.7	5.269	0.3	13.134	0.5
FINEP	140	0	466	0	337	0	6.847	0.3	1.163	0
BNC	0	0	0	0	0	0	130.611	6.5	0	0
Besc	9.068	0.9	13.762	1.2	24.508	1.4	0	0	0	0
BEP	1.570	0.2	460	0	342	0	0	0	0	0
Total	1.033.633	100	1.114.277	100	1.690.726	100	2.014.977	100	2.462.960	100

BNC incorporated in 11/30/2009

Besc incorporated in 09/30/2008

BEP incorporated in 11/28/2008

Source: MP/DEST/SIEST

The auditor's report also mentions BNDES in different areas of its text and provides critical information on what is still not transparent in the bank's balances and reports. In the section dedicated to credit policies, the TCU points out that in 2010 the credit operations in the national financial system (SFN) reached the highest rates in Brazilian history, amounting to R\$1.7 trillion and representing 46.4 percent of GDP. The allocation of resources to BNDES in this area (credit lines) has increased to 44 percent since the previous year and came out to US\$87 billion in 2010. In addition, other bank operations are directly subsidized through subventions by the National Treasury – an estimated US\$4.3 billion between 2009 and 2010, and many of the credit concessions made by BNDES with low interest rates have been at least 10 percent subsidized by public funds. TCU emphasizes that financial and credit benefits offered by the bank to enterprises and entrepreneurs are not fully captured by the controlling and tributary authorities.

The movement toward transparency was further strengthened by the new Law for Public Access to Information, which demanded the creation of a service dedicated to informing interested citizens and a proper procedure for information demands. The application of this law is already visible in BNDES' structure and website, where a specific web page offers an organized list that redirects browsers to the available information, such as Audit Reports, expenditure balances, contracts and agreements, institutional framework, programs and projects, frequently asked questions, and other topics. To solicit information that is not available in the website and published reports, any citizen or organization can fill a specific form to demand access, though the bank emphasizes that information will not be disclosed if it demands additional analysis, interpretation, or consolidation of data or if it deals with services or productions that are not of BNDES' competence. They will also not disclose information that is classified as personal, secret, confidential, or reserved, as well as other secrets with classifications such as fiscal, banking, professional, judicial, and so on.

⁷⁵An approximate amount in dollars can be reached roughly by dividing these values by two. Found in End-Year Report, /Prestação de Contas da Presidência da República, 2010, available at:

<http://www.cgu.gov.br/Publicacoes/PrestacaoContasPresidente/2010/Arquivos/PCPR2010.pdf>

4. Social control and Participation

Pressure for more transparency and accountability regarding BNDES' disbursement and investment options have grown in proportion to the bank's portfolio. Negative impacts of social and environmental spheres done by ventures with credit or capitalization from BNDES strengthened the demands for clearer objectives, civil responsibility, and financing withdrawals. In 2007, discontent arose in social movements and sectors with the presentation of the *BNDES Platform*, a document prepared by thirty of the most representative social organizations assessing the bank's performance and demanding a redirection of its line of action toward social justice and environmental protection.

This document pointed to the necessity of establishing mechanisms for social control over the bank's activities and of diversifying and decentralizing the bank's investments. The proposals and comments contained in the *Platform* had four main purposes: 1) publicity and transparency; 2) social participation and control mechanisms; 3) the adoption of social and environmental criteria in the election process of projects for funding and supporting; and 4) the restructuring of the bank's priorities through new sectorial policies. Until 2009, the *Platform* maintained a direct channel with the bank president's office, with the main purpose of pushing the agendas of adopting: (a) a transparency policy regarding information on all projects and investments; and (b) social and environmental impact criteria for the projects that the bank finances, especially in the hydroelectric and ethanol production sectors. Through this dialogue, BNDES did little to reorient its policies and to enforce these criteria on existing contracts, which indicates that the bank does not assume any social or environmental responsibility over the ventures it finances.

The objective of the *BNDES Platform* is more than exercising social control over the bank's budget and balances or seeking to create a more democratic governance of its resources. One of the main points of the document is that BNDES does not disclose the totality of its portfolios, especially of private investments and allocations, which the bank began publishing, though lacking clarity, in 2008. In that same year, the bank also signed the "Green Protocol" with the Ministry of the Environment, committing to adopt social and environmental criteria when selecting projects and enterprises for credit extensions or funding. The bank also restructured its environmental policies, adopting in 2010 a specific social-environmental policy within its operations, but still it has not established strict goals and measures to be taken, meanwhile continuing to finance high-risk or high-impact ventures.

These changes came about in the context of the World Bank's Sustainable Environmental Management (SEM) project for Development Policy Loan (DPL), which in 2009 approved a transfer of US\$1.3 billion of IBRD funds to BNDES in order to finance the improvement in effectiveness and efficiency of policies and guidelines of the Brazilian SEM system and the further integration of environmental sustainable development principles in the agenda of key economic sectors. This loan followed another, previous, fund transfer from IRBD destined to create more efficiency and celerity to the environmental licensing process (known as TAL SAL).

In this social-environmental policy, the bank commits formally to the Brazilian environmental legislation, observing the proper three-step procedure for licensing the projects it finances, and to the evaluation of and compensation for possible impacts. The institutional advances were made mostly in the creation of risk-assessment instruments, but still it hasn't clarified the contractual mechanisms that oblige enterprises and entrepreneurs to mitigate and correct expected and unexpected social-environmental impacts, neither the monitoring and control procedures to be exercised during the venture's operation.

The bank has begun producing sectorial social-environmental guidelines, in order to extend technical support to the different BNDES units that analyze these aspects of the projects, beginning with the sugar and alcohol sector, followed by soy production and cattle growing sectors. According to the bank, these guidelines should serve as orientations, and its contents do not create additional

obligations other than those in the Brazilian legislation and in the resolutions of the bank's board of directors. BNDES has also developed an environmental classification with three categories that grade the ventures in terms of risks and impacts. The policy determines that these environmental categories establish different procedures in terms of both pre-funding project analysis and monitoring of their operation, but in most cases, these classifications do not mean any contractual changes, nor do they represent effective obstacles to the occurrence of irregularities, disasters, violations or negative impacts of social rights and environmental laws.

The bank only established additional obligations in terms of social-environmental criteria in three specific economic sectors: 1) ethanol production, in which the bank cannot finance ventures located in the Amazon or Pantanal biomes; 2) thermoelectric and fuel production, for which there are restrictions regarding emission of particles into the atmosphere; and 3) cattle growth and meat production, which must keep the cattle traceable and maintain a complete list of suppliers. These obligations, however, depend on each beneficiary's own declarations since the bank does not dispose of instruments for independent monitoring of their observance.

In regard to the bank's legal responsibility over the projects and ventures it finances – such as its obligation to avoid, compensate, and mitigate eventual damages or impacts – Brazilian legislation establishes the solidary responsibility of financing agents in relation to the enterprises that violate human and environmental rights. This civil and administrative responsibility is clear in the law that disciplines the National Environmental Policy (PNMA), which also determines that the financing agent must observe if there are the necessary licenses for the venture and if the set obligations created by these licenses are being obeyed.⁷⁶ In addition, any corporation or financial institution is subject to penal responsibility in the case of environmental crimes, including their president, directors, administrators, board members, auditors, and others who are directly involved with or who fail to avoid the impacts and damages caused.⁷⁷

The main argument against the solidary responsibility of financial agents is the identification of the legal causal link between the financing and the damages caused by the enterprise. Although the argument has some legal basis, it does not apply to BNDES. Since it finances 60 percent to 80 percent of the projects' values, the mere possibility of the venture – and therefore, the damage it causes – depends on the bank, suggesting its complete responsibility. BNDES also holds shares in most of these corporations or in the conglomerates or holdings that control them. This fact also shapes the bank's direct, indirect, and solidary responsibilities.

Despite the referenced legal and institutional framework regarding social and environmental protections, BNDES continues to finance ventures that involve high risks and costs in these areas. In theory, the PNMA allows the application of legal penalties on project financiers through solidary responsibility for damages, but the judicial system is yet to enforce these legislative possibilities. Up until 2007, there were only two known decisions on the matter, made by one of the Federal Regional Courts, in which Caixa Econômica Federal (CEF) and BNDES – both IFFs – were defendants, but they were absolved of any responsibility. The procedures against BNDES were initiated by a group of local people that suffered with social and environmental damages that resulted from a mining venture financed by the bank. The Public Prosecutor's Office, however, has declared that the bank can be held accountable only if evidence of the bank's previous knowledge of the possibility of damage is produced. Even though there is no jurisprudence on financier's solidary responsibility yet,

⁷⁶ Law n° 6.938 of 1981, available at http://www.planalto.gov.br/ccivil_03/leis/L6938compilada.htm; and Article 12 of the Law n° 6.938 of 1981.

⁷⁷ Articles 2 and 3 of Law n° 9.605 of 1998, available at http://www.planalto.gov.br/ccivil_03/leis/L9605.htm

the growing possibility of the judicial recognition of this legal mechanism has moved organizations to pressure the public offices and to propose proceedings against these financiers, especially public ones like BNDES and CEF. In turn, these IFFs have gradually begun enforcing preventive measures to avoid this possibility, such as improving their scrutiny procedures for projects with environmental risks and demanding better guarantees and preventive and damage-control policies from the enterprises.

The *BNDES Platform* has worked toward exposing these contracts in hope of avoiding further social or environmental damages, such as the legal representation sent to the Federal Public Prosecutors Office about the ThyssenKrupp CSA, the largest steel and iron industrial complex in Latin America. In this case, BNDES has already disbursed 90 percent of its pledged financial support of US\$1.2 billion even though the venture has numerous social and environmental risks and was not given the proper operational license. The contract between the bank and ThyssenKrupp, which enabled the legal action by the *Platform*, was obtained by one of its institutions - the *Instituto Mais Democracia* - through the Law for Public Access to Information.

Annex 2: Petrobrás

Created in 1953, during Getúlio Vargas' term as a democratic President (1951-1954), the *Petróleo Brasileiro S.A.* (Petrobrás) began as a partnership with shared capital, controlled by the government through its shareholding (with its subsidiaries) in the company's divisions for the exploration, production, refining, and offshore and pipeline transportation of oil, gas, and their by-products. The corporation's creation represented an important victory for the state-led development (*desenvolvimentismo*) policy option – given that the Constitution in place at the time (from 1946) allowed foreign capital to participate in this sector – and was a positive response to the national campaign titled “O Petróleo é Nosso” (The Oil is Ours) that started in 1948.

The liberal reaction to the petroleum crisis and welfare state pact was based on the guidelines for economic liberalization, productive restructuring, and capitalist globalization, which in practice meant deregulation, privatization of SOEs, cutback on social expenditures by the state, and opening of the market to foreign investors. This led to profound changes in the economies of many nations, including those in Latin America, where these impacts were felt in the growth of foreign debt that exhausted the capacity of government to lead in developmental programs and policies. In the case of Brazil, the new democratic Constitution (1988) established in article 177 that the exploration for and production of oil and its by-products was to be a monopoly of the state through its SOE, Petrobrás. This prevented the 1990s National Privatization Program, responsible for privatizing many of the largest SOEs, from reaching Petrobrás and took advantage of the strong national feeling that revolved around company.

Given this legal and social situation, the legislative decision to avoid privatizing the company and, at the same time, to adapt it to new market requirements marked an end to the state's monopoly over oil exploration in Brazil. Through Constitutional Amendment n° 9 (1995) and its regulating law, n° 9.478 (1997) – known as the Oil Law – private capital was permitted, by means of concessions, to explore and produce oil on national territory and to buy shares from Petrobrás, although the state remained the company's major shareholder.⁷⁸ The Oil Law also determined the activities of the National Agency for Oil, Natural Gas, and Biofuels (ANP), which had been created in part to enforce the law, hire and fire, and regulate activities in the sector. Petrobrás is a private equity open capital corporation that has a mixed shareholding structure with private and public capital holders, although the state remains the majority shareholder. Operating in an integrated system, the company's objective is to explore and produce, refine, commercialize, and transport oil and its by-products, such as natural gas, biofuels, and electric power, among other petrochemical activities. As the leader of the Brazilian oil sector, it has a presence in 28 countries around the globe, maintains operations in 24 of those countries and has representation offices in China, Japan, USA, Singapore, and England. The company develops exploration and production activities in 19 countries, operates refining and petrochemical activities in

⁷⁸Two articles of Law n° 9.478 of 1997 (known as the Oil Law) contribute to defining the new bidding terms for exploratory blocks after breaking Petrobrás' monopoly: Art. 23. Oil and natural gas exploration, development and production activities will be exercised by means of concession contracts, preceded by auctions, as hereby provisioned.

Art. 26. The concession implies that the concessionaire will have the obligation of exploring, at their own risk, and, if successful, producing oil or natural gas in a given block, conferring ownership of these goods, after they have been extracted, with the dues relative to paying the relevant taxes and corresponding legal or contract participations.

four of them, produces gas and energy in three, and maintains distribution and commercialization in eight. The company has 81,918 employees, 125 production platforms – 77 fixed and 48 floating – which produce daily 2,621,000 barrels of oil and liquefied natural gas and 452,000 barrels (oil equivalent) of natural gas in Brazil and abroad. The company also operates 15 refineries which process 2,004,000 barrels of by-products per day, maintains 30,067 kilometers of pipelines, seven biofuel plants (five production plants and two experimental ones), 16 thermoelectric power plants, four wind energy plants, and two fertilizer manufacturing facilities. It utilizes 242 ships, of which 52 are its own property.⁷⁹

The importance of the company to the Brazilian economy may be demonstrated, first, by its contribution to the GDP, which in 2011 was calculated at R\$ 4.1 trillion (approximately US\$2.3 trillion).⁸⁰ Based on Bacocoli's (2008) estimates, Petrobrás represents 90 percent of the country's oil and gas sector,⁸¹ and the company's evolving contribution to the Brazilian GDP according to other studies is:

- in 2004, 7.3 percent of the Brazilian GDP (Aragão, Machado, and Schaefer, 2005);
- in 2007, 10.8 percent of the Brazilian GDP, (BNDES & others, 2009); and
- in 2012, 10.8 percent of the Brazilian GDP, (CNI & IBP, 2012).⁸²
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Another way to illustrate Petrobrás' importance to the Brazilian economy is through an overview of the oil sector's contribution to the national tax collection. According to a study done by Afonso & Castro, the oil sector contribution to the GDP amounted to 2.67 percent in 2009.⁸³ Since the Brazilian tax load represented an average of 34.98 percent of the GDP for that same year, it can be mathematically inferred that the oil sector accounted for 7.64 percent of the tax collected.⁸⁴

1. Institutional Framework, Equity Structure, and Governance

As a public corporation controlled by the federal government, Petrobrás is an entity connected to the Ministry of Mines and Energy (MME), which has a range of responsibilities, including:

⁷⁹ See Petrobrás website, www.petrobras.com.br

⁸⁰ Brazilian Institute of Geography and Statistics, "Contas Nacionais Trimestrais-Indicadores de Volume e Valores Correntes," Comunicação Social, March 6, 2012, available at: http://www.ibge.gov.br/home/presidencia/noticias/noticia_impressao.php?id_noticia=2093

⁸¹ Bacocoli, Giuseppe (2008). Interview given to Folha de S. Paulo Online on 24/08/2008. Viewed 09/28/2012. Available at <http://www1.folha.uol.com.br/folha/dinheiro/ult91u437281.shtml>

⁸² The studies are: Aragón, Amanda P.; Machado, Giovani V.; Schaefer, Roberto. Estimativa da Contribuição do Setor Petróleo ao PIB Brasileiro: 1955 A 2004. In: 3º Congresso Brasileiro de P&D em Petróleo e Gás, 2005, Salvador-BA. Anais do 3º. Rio de Janeiro, Instituto Brasileiro do Petróleo, 2005; BNDES, Bain & Company, Tozzini Freire Advogados. Estudos de Alternativas Regulatórias, Institucionais e Financeiras para a Exploração e Produção de Petróleo e Gás e para o Desenvolvimento industrial da Cadeia Produtiva de Petróleo e Gás no Brasil. São Paulo, 2009. Available at http://www.bndes.gov.br/SiteBNDES/export/sites/default/bndes_pt/Galerias/Arquivos/empresa/pesquisa/chamada1/Relat_III.pdf; Confederação Nacional da Indústria (CNI); Instituto Brasileiro de Petróleo, Gás e Biocombustíveis (IBP). A contribuição do setor brasileiro de petróleo, gás e biocombustíveis para o desenvolvimento sustentável no país. Confederação Nacional da Indústria. Instituto Brasileiro de Petróleo, Gás e Biocombustíveis. – Brasília: CNI, 2012. The way the GDP is presented by the Brazilian Institute of Geography and Statistics (IBGE), it is not possible to construct an aggregated indicator of the all segments that compose the oil sector. Information on the input-output matrix is available, most recently, for the year 2005.

⁸³ Afonso, José Roberto, and Castro, Kleber Pacheco de (2010). *Tributação do Setor de Petróleo: Evolução e Perspectivas*. Texto para Discussão nº 12, ESAF. Brasília, Jun/2010. p. 34. Available at: <<http://bit.ly/hOUv6N>>.

⁸⁴ This percentage was obtained by the simple formula $(2.67\%/34.98\%)*100 = 7.64\%$.

- The Minister's Cabinet is in charge of "*intermediating relations between citizens and the Ministry, playing ombudsman roles, including the enforcement of measures that are necessary in the realm of internal agencies and **related entities***";
- The MME's Executive Secretariat is in charge of "*assisting the state Minister in *supervising and coordinating the activities of related entities**", as well as "*coordinating, guiding, supervising, and consolidating the *development of an investment budget and a global expenditures program of the related entities*, articulating them with those of the central agency of the Federal Planning and Budgeting System";*
- The MME's Special Assistant for Social Environmental Management is in charge of "*implementing a management system for social environmental issues associated with developments in the energy sector, in articulation with the other agencies of the Ministry and related entities.*"⁸⁵ (Emphasis added.)

Petrobrás' corporate governance is structured around the presidency and the board of directors of the seven major areas of the company's activities: 1) financial; 2) gas and energy; 3) exploration and production; 4) supply; 5) international; 6) engineering, technology, and materials; and 7) corporate services. Petrobrás also has an office of the general "ombudsman," an internal auditor's office, and two important councils: the fiscal council and the administrative council. The fiscal council is composed of five members: three representing the federal government as controlling shareholder, one representing the shareholders of ordinary voting stock, and one representing shareholders of preferred stock. The administrative council is composed of ten members: seven from the federal government as controlling shareholder, which include the company's president, Ms. Graça Foster, the president of BNDES, Mr. Luciano Coutinho, and the Minister of Finance, Mr. Guido Mantega, who is president of this council; one representing shareholders of ordinary voting stock, currently occupied by the president of the Brazilian textile corporation Coteminas and son of the former Vice-President for the Lula Administration, Mr. Josué Gomes da Silva; one representing shareholders of preferred stock, currently occupied by Mr. Jorge Gerdau Johannpeter, leader of the Brazilian corporation Grupo Gerdau S.A., one of the biggest steel producers in the world; and one representing the workforce, in compliance with the determinations of the new law that addresses the participation of employee representatives with voting rights on SOEs' administrative counsels, by a separate and direct vote by his peers. The ordinary General Assembly meeting held on March 19, 2012, which elected Mr. Gomes da Silva and Mr. Gerdau Johannpeter as representatives, raised questions and was investigated by the CVM in order to determine if there was any illegal or political interference.⁸⁶ Minority investors are concerned since their announced representatives, Mr. Mauro Rodrigues da Cunha, president of the National Association of Investors on the Capital Market (AMEC) and former president of the Brazilian Institute of Corporate Governance (IBCG), and the international manager Mr. Francisco Carlos Drohojowski were not elected to the posts. In an open letter signed by the Mr. Rodrigues da Cunha and ratified by the 16 foreign groups, the minority shareholders requested greater guarantees that their representatives are actually chosen by them, since in the last election, votes from shareholders clearly tied to the government, such as SOEs' pension funds (Petros, Previ, and Funcef) and BNDES were decisive, which calls into question

⁸⁵ Decree n° 7.798 of 2012.

⁸⁶ Lei n° 12.353 de 2010, available at http://www.planalto.gov.br/ccivil_03/_Ato2007-2010/2010/Lei/L12353.htm

their classification as independent minority shareholders and, thus, their ability to vote for these representatives.⁸⁷

The company's capital stock was determined by the General Assembly in an extraordinary session held on March 19, 2012, to be US\$101.2 billion). Investments anticipated for 2012 amounted to US\$28.9 billion) and are distributed as follows: 59.02 percent for the area of Exploration & Production; 33.10 percent for Supply; 5.42 percent for Gas and Energy; and 2.46 percent for the other business areas.

The federal government is the controlling shareholder of the company, with 50.2 percent of ordinary shares in 2011 (see Table 1), with voting rights that give it ample control over the company, including an ensured majority of votes in General Assembly deliberations and the capacity to elect most of the company's top management. The extent of the state's economic control over Petrobrás can be demonstrated through examining the sum of its ownership of the four other major shareholders:

- 1) BNDES (National Social and Economic Development Bank) is an incorporated public company, whose total registered stock (without face value) belongs to the Federation, playing the role of main instrument for the execution of the federal government's investment policy and its primary objective is to support programs, projects, public works, and services that are related to the social and economic development of the country (Decree n° 4.418 of 2002).
- 2) BNDESPAR (BNDES Participações S/A) is an equity company, incorporated as Wholly-Owned Subsidiary to BNDES, whose objectives involve, among others: conducting operations to capitalize businesses controlled by private groups, observing BNDES plans and policies, and contributing to a stronger capital market by increasing the supply of securities and democratizing capital ownership in companies.
- 3) The Social Participation Fund (Fundo de Participação Social) has the objective of promoting worker participation in the equity of national companies. It functions as a BNDES managed subaccount of the Profit Participation Program (PIS) and the Civil Servants' Investment Program (PASEP).
- 4) Brazil's Sovereign Fund – FFIE (Fundo Soberano Nacional ou do Brasil) is a special accounting and financing fund connected to the Ministry of Finance, created by Law n° 11.887 of 2008, that has the purpose of promoting asset investments in Brazil and abroad, developing public savings, mitigating the effects of economic cycles, and fostering overseas projects of strategic interest to the country.

Both tables below present Petrobrás' equity structure. Table 1 illustrates in detail the shareholders and their participation in 2011, while Table 2 is a broader spectrum analysis of the general stockholding distribution over the last three years (2009 thru 2011). The second table also presents the increase in participation of shareholders that represent the federal government in the company's social capital, which went from 39.8 percent in 2009 to 48.3 percent in 2010, especially due to the increase in shares owned by the BNDES (from 0.1 percent in 2010 to 3.4 percent in 2011). This increase is due to the so-called "Petrobrás capitalization process," regulated by the Law n° 12.276 of 2010 and described below.

⁸⁷ Valor Econômico, "Assembleia da Petrobrás é investigada pela CVM" and "Estrangeiros criticam eleição de Conselho e plano da Petrobrás," 08/20/2012, available at <http://www.valor.com.br/empresas/2819650/estrangeiros-criticam-eleicao-de-conselho-e-plano-da-petrobras> and <http://www.valor.com.br/empresas/2794780/assembleia-da-petrobras-e-investigada-pela-cvm>

Table 1: Petrobrás' Equity Structure in 2011 (Common and Preferred Stockholders)

Shareholders	Common Stock		Preferential Stock		Capital Stock (Common + Preferential Stock)	
	Stocks	%	Stocks	%	Stocks	%
Federal state	3.738.835.217	50.2%	-	0.0%	3.738.835.217	28.7%
BNDESPAR	173.400.392	2.3%	1.341.348.766	23.9%	1.514.749.158	11.6%
BNDES	442.001.218	5.9%	-	0.0%	442.001.218	3.4%
Fundo de Participação Social (FPS) - Social Participation Fund	6.000.000	0.1%	2.433.460	0.0%	8.433.460	0.1%
Fundo Soberano (FFIE) - Sovereign Fund	344.055.327	4.6%	161.596.958	2.9%	505.652.285	3.9%
ADR Level 3	1.596.548.816	21.5%	1.596.850.138	28.5%	3.193.398.954	24.5%
FMP-FGTS Petrobras	173.760.453	2.3%	-	0.0%	173.760.453	1.3%
Foreigners (Resolution n°2689 CMN)	420.432.235	5.6%	802.385.635	14.3%	1.222.817.870	9.4%
Remaining individuals and corporations	547.420.484	7.4%	1.697.427.831	30.3%	2.244.848.315	17.2%
TOTAL	7.442.454.142	100%	5.602.042.788	100%	13.044.496.930	100%

Source: Petrobrás Sustainability Report 2011

Table 2: Petrobrás' Equity Structure in 2009, 2010, and 2011 (Sum of Common and Preferred Stockholders)

Shareholders	PETROBRAS EQUITY STRUCTURE (Capital Stock)					
	2009		2010		2011	
	Stocks	%	Stocks	%	Stocks	%
Federal state	2.818.751.784	32,1%	4.057.432.419	31,1%	3.738.835.217	28,7%
BNDESPAR	672.504.334	7,7%	1.514.749.158	11,6%	1.514.749.158	11,6%
BNDES	-	0,0%	218.845.426	1,7%	442.001.218	3,4%
Fundo de Participação Social (FPS) – Social Participation Fund	-	0,0%	8.443.460	0,1%	8.433.460	0,1%
Fundo Soberano (FFIE) – Sovereign Fund	-	0,0%	505.652.285	3,9%	505.652.285	3,9%
ADR (common stock)	1.306.053.702	14,9%	1.521.989.590	11,7%	1.596.548.816	12,2%
ADR (preferential stock)	1.302.320.170	14,8%	1.477.085.956	11,3%	1.596.850.138	12,2%
FMP-FGTS Petrobras	177.777.693	2,0%	183.772.748	1,4%	173.760.453	1,3%
Foreigners (Resolution n°2689 CMN)	795.767.784	9,1%	1.190.957.444	9,1%	1.222.817.870	9,4%
Remaining individuals and corporations	1.700.901.273	19,4%	2.365.578.444	18,1%	2.244.848.315	17,2%
TOTAL	8.774.076.740	100%	13.044.506.930	100%	13.044.496.930	100%

Source: Petrobrás Sustainability Report 2009, 2010, 2011.

The Petrobrás' capitalization process, considered one of the largest operations of its kind in the world, and its consequences are briefly described in the box below. These consequences raised the question of the conflicting roles held by the federal government as it increases its participation in the company to enable it to explore a potential venture with exclusivity and the public regulation of the sector. The National Petroleum Agency (ANP), which is the regulating agency for all activities of the oil and gas industry and bio-combustibles in Brazil, is part of the state's indirect administration, connected to the Ministry of Mines and Energy (MME), like Petrobrás. In theory, the ANP has administrative independence and financial autonomy, but indirect institutional ties mean that the company's interests are entangled with regulatory procedures.

Box: Capitalization of Petrobrás

Main motivations

To leverage Petrobrás' investments required to explore the sub-salt area;
To alleviate the company's indebtedness, which reached 34 percent of its net worth in June of 2010.⁸⁸

General proceedings

Authorized by the Law nº 12.276 of 2010, the capitalization may be summarized as follows:

The National Treasury issues public debt bonds to acquire new Petrobrás shares, thus increasing its shareholder equity;

Petrobrás uses these bonds to acquire, from the state, the right to explore and extract hydrocarbons from the sub-salt area, up to a limit of 5 billion barrel of oil equivalent (BOE) from the state's exploratory areas that have not been auctioned yet;

The money to be invested in Petrobrás would come from the execution of the right to increase participation proportionally to the new state's capital increment by minority shareholders.

Main results

The operation, concluded in September 2010, resulted in:

The capitalization of US\$69.9 billion in new shares acquired by means of Treasury bonds and increased participation of minority shareholders;

The use of US\$43.5 billion in bonds to acquire the right to extract up to 5 billion BOE from the state's territory;

The capitalization US\$26.4 billion in cash (increased participation) in the company's assets;

The raise of the state's participation in the Company's social capital from 39.8 percent in 2009 to 48.3 percent in 2010.

Controversies:

Petrobrás and ANP (National Oil Agency), by means of independent third-party consultation, diverged about setting the price of the ground barrel to be granted from the Federation to Petrobrás (set after a heated dispute at US\$8.51/barrel);

Since the main criticism about the state's investments in Petrobrás revolves around large public resource transfers to increase the company's value – which results in the increase of revenue and interests for private shareholders, including foreign agents – the capitalization tried to minimize this issue by increasing direct federal participation in the company, as a way to show the public control of Petrobrás in detriment of private shareholders.

Sources: Folha de São Paulo <http://www1.folha.uol.com.br/mercado/797612-endividamento-no-limite-motivou-capitalizacao-da-petrobras.shtml>; Law nº12.276/2010; and Petrobrás Sustainability Report 2010

The discussion about the different roles played by the federal government in relation to the oil and gas sector and, by extension, to Petrobrás, cannot be isolated from the political perspective. After all, how can the federal government's excesses or shortcomings in this sector be evaluated if we do not address the issue of a state-owned company's social role?

⁸⁸ Rating agencies stipulate a company's cap indebtedness at 35% of the net worth in order to give it an *investment grade*.

Controlling an influential share of Petrobrás' capital stock, the state must be careful to act, when trying to obtain the greatest potential sustainability for the company, within the economic principles of free competition and in strict compliance with minority shareholder rights. The Petrobrás capitalization operation can be seen as an example of the state's interest in preserving the company's profitability, since the process increases the company's net worth and capital stock, while allowing it to push its exploration activities to new boundaries. On the other hand, as the sector's regulator, the state has acted mostly through the National Petroleum Agency (ANP), which reports to the Ministry of Mines and Energy (MME). The following three responsibilities of the ANP illustrate some of the conflicting roles the agency faces as it acts as the sector's regulator toward Petrobrás, which is itself an important instrument for executing the government's public policies. They are:

- To establish public invitations for bidding to win concessions to explore, develop, and produce oil, gas, and biofuels, approving contracts to regulate these activities and later inspecting their execution and results;
- To authorize the activities of refinement, processing, transportation, treatment, storage, and other chemical and physical conditioning procedures to oil, gas, and biofuels;
- To guide legal processes that aim at declaring public utility for expropriation purposes or to institute administrative rules for the areas deemed necessary to explore, develop, and produce petroleum and natural gas and to build refineries, terminals, and pipeline networks.

Finally, the federal government, as a public policy promoter, eventually relies on Petrobrás' investment capacity, strategic position, and massive footprint in order to advance in its macroeconomic programs and needs – such as inflation control by banning fuel readjustments – and to effectively implement investment policies. It is clear that, ideally, whenever Petrobrás was called upon to promote public policies, all company expenses, and/or waivers should be duly accounted for and refunded by the National Treasury or by beneficiaries. The accountability of these policy expenses and their refund are important instruments in the maintenance of the separate roles played by the government in this sector – namely, that of major shareholder control over Petrobrás and that of regulating the sector – since it keeps Petrobrás competitive with other private companies that could not undertake similar activities. Transparency by the state as it plays these different roles in relation to Petrobrás is an important requirement to honor the company's responsible corporate management and competitiveness, as well as to allow a more truthful evaluation of these public policies' outcomes.

The boundaries between these roles, however, are very political. The use of Petrobrás in its public policies depends on the orientation of the government in place, which can be strictly liberal, treating the company as a private corporation, with minimal state intervention, or more interventionist, with the use of the company as a means to implement policies and programs. This debate is partly founded on potentially different ways to interpret the company's social function. According to the Law for Open-Capital Corporations, in the section that determines the duties of a controlling shareholder, "The controlling shareholder must use the power to lead the company to achieve its objective and comply with its social function and has duties and responsibilities with the other company shareholders and workers, and with the community where it operates, whose rights and interests it must truthfully

respect and meet.”⁸⁹ The details of this social function, however, are not specified and becomes especially delicate when dealing with SOEs. There is an inevitable ethical component in the fulfilling of this social function, since such activities as the generation of welfare, well-being, and self-esteem are difficult to measure and can take many forms, from social and environmental programs and educational investments to the maximization of profit returned to the National Treasury, which is indirectly to Brazilian society.

The exploration for oil and gas in Brazil, since the end of the monopoly, has been regulated under the concessions regime, as determined by the sector’s regulating law.⁹⁰ However, since there is still a monopoly on the ownership of reserves, private investors must pay financial compensations for the resource extraction, known as “government participations” that are paid to the National Treasury and later transferred to states, municipalities, and other legal beneficiaries. They are:

- *Signature Bonus*: in a concession auction or bidding, the government sets a minimum amount to be paid by the winner to explore the determined area, and the signature bonus is the amount pledged in the winning bid, to be paid upon the signing of the concession contract;⁹¹
- *Royalty*: amounts paid to different federal entities (union, states, and municipalities) at the rate of 10 percent of the value of production, which may be reduced to 5 percent and made in monthly payments;⁹²
- *Special Participation*: amounts paid only by investors in areas with high level of production, these rates vary from 0 percent to 40 percent over the net revenue of production and made in quarterly payments, similarly to the well-known “windfall profit tax” used by several oil-producing countries;
- *Occupancy or Retention of an Area*: payments to be made annually, set per square kilometer or fraction of the surface of the concession’s oil reserve block.

Usually, the royalties and the special payments account for most of the revenue collected for oil and gas exploration, amounting to around US\$12 billion in 2011, according to the ANP’s data. Both of these payments are destined to the federal government and its administration, as well as the states and municipalities, where the exploration and production take place or, in the case of ventures on the continental shelf, to the states and municipalities that the legislation considers as impacted by the activities.

However, the oil and gas sector is being restructured in Brazil through the New Regulatory Framework (NMR), in discussion since 2009, when it began debating new formulas to distribute the royalties of the exploration and production. Other aspects of the NMR, however, point to the definitive positioning of Brazil as an “oil giant” in the international market, under national command over the wealth produced by oil and gas explorations, especially through Petrobrás’ venture in the recently discovered pre-salt

⁸⁹ Lei das S.A. nº 6.404 de 1976, available at http://www.planalto.gov.br/ccivil_03/leis/L6404consol.htm; and Lei das S.A. nº 6.404 de 1976. Art. 116.

⁹⁰ Lei nº 8.987 of 1995, available at http://www.planalto.gov.br/ccivil_03/leis/L8987compilada.htm; and Lei nº 9.478 of 1997. Articles 4 and 5, available at http://www.planalto.gov.br/ccivil_03/leis/L9478.htm

⁹¹ In accordance to the Lei nº 9.478 of 1997, Article 46.

In accordance to the Lei nº 9.478 of 1997, Article 47.

layer. Critics of this current action in the sector speak of a disguised “re-nationalization” of the sector, with clear movements toward monopoly of certain segments of this economic activity.

In this scenario, the NMR is settled upon four main objectives, synthesized in three federal laws approved in 2010, which are: 1) to create the Production Sharing Agreement (PSA), which is an alternative to the adoption of the concession regime, used on the exploration of oil and gas in the continental territory; 2) to create the Social Fund (SF) as a major beneficiary of the governmental revenue from the PSA; 3) to create the enterprise Pre-Salt Petroleum S.A. (Petróleo Pré-Sal S.A. (PPSA), as the government-owned company in consortium included in the PSA; and 4) to obtain financial inputs for Petrobrás.⁹³ The PSA⁹⁴ is to be the only form of contract that may be applied to the oil reservoirs located in the sub-salt polygon layer and in those areas defined by as strategic.⁹⁵ The option for the PSA had multiple reasons, including the government’s desire to increase national sovereignty, since the PSA – unlike the concession regime – keeps the resource extracted (oil) as state property, and its growing understanding that the exploratory risks (such as the chances and consequent losses of drilling a dry well) in the sub-salt polygon layer and in the strategic areas, can be paid for by the profit generated by successful ventures. The PSA offers the state more control over the distribution of the wealth obtained from the exploration of the pre-salt polygon layer and the strategic areas, which is in line with the general public understanding that these resources and their profit belong, ultimately, to the Brazilian society. Under this agreement, the oil and gas extracted by a contractor will continue to belong to the federal government, which in turn authorizes part of the production to cover its costs (so-called *cost oil*), incurred solely by the contractor, while the excess oil (so-called *profit oil*) is split between public and private beneficiaries.⁹⁶

Concerning the third and fourth objectives, there are three main enablers present in the current sector’s context:

- 1) The state’s possibility of waiving contracts and directly entering into a PSA with Petrobrás, establishing a business consortium between the company and the PSA members;
- 2) The possibility of Petrobrás being nominated operator of all areas under the PSA, with an ensured minimum 30 percent participation in all exploration ventures. That is, should there be another contractual concession over the reservoirs, the winning company will have to establish a consortium with both PSA members and Petrobrás (which will have no less than a 30 percent participation in shares) and will be subject to the rules contained in the contract protocol and winning proposal;

⁹³ The first two objectives are covered by Law n° 12.351 of 2010; the third one is ruled by Law n° 12.304 of 2010; and the fourth, by Law n° 12.276 of 2010.

⁹⁴ By “production sharing,” the law means the “agreement for the exploration and production of oil, natural gas, and other fluid hydrocarbons where the contractor exercises the exploration, assessment, development, and production activities, at their own risk, and, in case of any commercial finding, acquires the right to ownership of the oil cost, of the volume of production corresponding to royalties due, as well as the portion of excess oil, as per the proportion, conditions, and terms established in the contract” (Law n° 12.351 of 2010, Article 2, section I).

⁹⁵ By “strategic area” the law means the “region of interest for national development, established by an act of the Executive Branch, characterized by the low exploratory risk and high potential for producing oil, natural gas, and other fluid hydrocarbons” (Law n° 12.351 of 2010, Article 2, section V).

⁹⁶ By “oil surplus” the law means: “the portion in the production of oil, natural gas, and other fluid hydrocarbons to be shared between the Federation and the contractor, according to criteria set forth in a contract, resulting from the difference between the total volume of production and the portions related to the oil cost, the royalties due, and, when applicable, the participation addressed by Article 43” (Law n° 12.351 of 2010, Article 2, section III).

- 3) The rights transferred to Petrobrás for the exploration of a portion of the pre-salt polygon layer, an operation that generated US\$42.5 billion for the National Treasury in 2010. This revenue was used, in part, to capitalize Petrobrás and increase the Brazilian state's equity participation in the Company, which also added another US\$25.7 billion from minority shareholders that increased their participation proportionally in the Company's stock structure.⁹⁷

The first two items refer to the government's participation in all PSA consortia; its roles include managing these PSAs and hiring a company – which could be Petrobrás – to commercialize the government's share in the sector's production. The preference for Petrobrás as the company which will represent the government in PSAs and in the market for government's shares from oil and gas is another reason that the critics interpret the NMR as a nationalizing step, particularly those who understand oil to be a mere commodity rather than as a basic and strategic resource that should, preferably, remain under state control. On the other hand, another alarm could be raised if Petrobrás is chosen as the company to explore these new layers and areas and to commercialize the government's shares in the market, since it is still an SOE, which ultimately means that public resources are at risk in these ventures.

In addressing the process of capitalizing Petrobrás, which made possible the exploration and production of sub-salt layer reserves, many uncertainties revolve around the size of the financial investment required for the success this long-term venture. In the negotiations of the rights for Petrobrás to extract 5 billion barrels from this layer, production cost estimates hovered between 5 and 12 dollars/barrel. In this context a number of problems arise:

- Since a long-term period is necessary for the maturation of the investments – the period between the disbursement and the actual profit – the potential revenues from sub-salt layer explorations must be accounted for within the financing and funding agreements;
- Petrobrás indebtedness, largely supported by the public banks like BNDES, Caixa Econômica Federal (CEF), and Banco do Brasil (BB), represents a growing risk for the company's social function and public interests in the oil and gas sector since the interest rates for emitted public debt bonds varied between 11 percent and 15 percent in 2011, the interest rates for long-term financing schemes conceded by the Treasury follow international rates that revolve around 5 percent to 6 percent;⁹⁸
- Banned or restricted from operating in countries with substantial part of world reserves (Saudi Arabia, Iran, and Venezuela), international companies tend to be attracted to Brazil for exploration and production investments since the country's definitive economic opening in 1995, and especially since the gradual exhaustion of light and cheap Saudi oil has become foreseeable.

⁹⁷See the box above concerning the Capitalization of Petrobrás.

⁹⁸According to the *Folha de S. Paulo*, loans from BNDES to Petrobrás in May 2012 made history as the largest credit extension in Brazil and the world – R\$9.4 billion. The newspaper goes on to say that BNDES is also a shareholder of Petrobrás, with around 6 percent of shares and its subsidiary, BNDESPAR, has around 2 percent. In that same month, the total amount of approved loans and financing to corporations was around R\$21 billion, which means that Petrobrás is a big client for the bank but its portfolio remains diverse. See: “Crédito à Petrobrás fez o BNDES bater recorde histórico,” *Folha de S. Paulo*, 08 April 2012, available at: <http://www1.folha.uol.com.br/mercado/1131832-credito-a-petrobras-fez-o-bndes-bater-recorde-historico.shtml>

2. Performance, Investment Options and Quasi-fiscal Activities

An analysis of Petrobrás' recent performance and profitability – mostly since the capitalization process – is crucial to measuring the “opportunity cost” of the public capital employed in this company, considering the difficulties involved in an objective measurement of this cost due to its complex composition. Petrobrás' estimated market value was US\$149.3 billion on September 28, 2012, which was also a reduction from the US\$208 billion value recorded on the day of the company's capitalization, two years earlier, on September 27, 2010. More recently, in the second quarter of 2012, Petrobrás faced its first loss after 13 years, totaling US\$626 million, assessed according to international accounting principles issued by the International Accounting Standards Board (IASB.)⁹⁹ The reasons for this negative performance include those far-reaching ones that help explain the decrease in the company's market value in the past two years: 1) while Petrobrás still holds, in practice, a near monopoly of the refinement, importation, and transportation of petroleum in the country, domestic fuel prices are lagging behind evolving international oil prices, which further feeds investors' fears that a price gap will be maintained by governmental interference with the company's management; 2) there was a downturn in expectations for oil and gas production, coupled with an increase in the expectations for the costs required to explore and produce oil from the sub-salt layer reserves, while in 2012 some areas of production have reverted to 2009 levels, such as 1.9 barrels of oil per day produced domestically; 3) the company reached a net debt/equity ratio of 28 percent in September 2012, which raises alarms considering that in 2010, after the capitalization process, this ration was at the “healthier” 16 percent mark; 4) the company's diminishing credibility concerning its resistance to political interventions in its corporate management and in its by-products readjustment policies, in a context of increasing the government's shareholding participation in the company and emerging fear for the exclusion of minority and foreign stockholders from the company's main decisions.^{100, 101, 102}

In addition to these factors, there are other current issues that help explain the company's recent losses, such as the Brazilian currency's significant devaluation in relation to the dollar, which affected negatively the company's financial results by raising their dollar indebtedness and their dollar costs; the greater expenses incurred in shutting down dry or less-productive wells that had been drilled in the period 2009-2012, remarkably in new areas of explorations; and the reduced production of oil due to the maintenance of these shutdowns in an attempt to increase operational efficiency.¹⁰³ Still, the company's plan for the next five-year period (2012-2016) provides for US\$237 billion investments, which represents an average of US\$47.3 billion per year. According to the simplified Enacted Budget published by the Ministry of Planning, Budget, and Management (MPOG) – which is something like a

⁹⁹ See the box above concerning the Capitalization of Petrobrás; and Petrobrás, Central de Resultados, 2nd Trimester of 2012, available at <http://www.investidorpetrobras.com.br/pt/central-de-resultados/2t12.htm>

¹⁰⁰ “Competição: Quebra do monopólio não arranha supremacia da companhia no país; 50 Anos de Petrobrás (1953-2003).”, *Folha de S. Paulo*, 10 March 2003, available at <http://www1.folha.uol.com.br/folha/especial/2003/petrobras50anos/fj0310200307.shtml>

¹⁰¹ Although this fuel price stabilization can be interpreted as a quasi-fiscal activity, since there is no direct subsidy back from the government to Petrobrás to compensate its losses, on the other hand, the state and the company are involved in other, more complex, forms of compensations and subsidies that may also involve other quasi-fiscal activities, such as the use of the fuel-related economic mechanisms to control inflation.

¹⁰² Items 2 and 3, see Valor Econômico, “Assembleia da Petrobrás é investigada pela CVM,” 08/20/2012; and “Estrangeiros criticam eleição de conselho e plano da Petrobrás,” 09/05/2012.

¹⁰³ Petrobrás, Central de Resultados. Second Trimester of 2012, available at <http://www.investidorpetrobras.com.br/pt/central-de-resultados/2t12.htm>

Citizen Budget – investments in Petrobrás in 2013 will be around US\$43.6 billion, representing around 48 percent of the overall expenses on national public investment, which are around US\$91.2 billion.¹⁰⁴

The company's investment options also play a major role in determining its performance and profitability, and these decisions can be analyzed in part through their beneficiaries and their geographical position within the country. These investment options are also a fertile field for government intervention and enforcement of quasi-fiscal activities on this SOE. An example of a recent controversial decision was the construction of the Abreu & Lima S.A. Refinery in the state of Pernambuco, in Northeastern Brazil, as part of an industrial complex integrated with a port, in partnership with the Venezuelan oil company PDVSA. While the decision is within the company's interest to expand domestic refining capacity and improve distribution, it can also be argued that the location and beneficiary choices were politically determined, as a way of strengthening ties with the Venezuelan government and meeting the interests of the Pernambuco state government. The overlap of public policies and corporate decisions is recurrent and can be further illustrated by the refinery's construction within the new Special Regime of Incentives for Development of Infrastructure of the Petroleum Industry of the North, Northeast, and Center-West Regions (REPENEC), approved in Law n° 12.249 in 2010 and through which any corporation in the sector can receive federal tax and contributions exemptions as incentives. The Ministry of Mines and Energy (MME), to which Petrobrás is institutionally connected, with the support of the ANP, the sector's regulating agency, chose the projects considered adequate to participate in this special fiscal regime.

Quasi-fiscal activities undertaken by Petrobrás are difficult to identify clearly, since the SOE is part of an intricate system of assumed noncommercial expenditures and actions and diverse types of compensations, many of which are not declared or not distinguishable from the government's roles as institutional and shareholding owner of the company and as the sector's regulator – through the ANP, which is also connected to the MME. These complex relations of mutual compensations and undertakings between the state and Petrobrás are tangible in the excerpt below, taken from the Management Report for the Fiscal Year of 2011, prepared by the company for the Federal Court of Auditors:

The Brazilian government, in its role as our controlling shareholder, may require us to achieve certain macro-economic and social targets that may have a negative impact on our operating results and financial position [...]

The Brazilian government, in its role of controlling shareholder, has already achieved, and may achieve in the future, some of its macro-economic and social objectives through our company, as permitted by law. The Brazilian legislation requires the Federal government to hold the majority of voting stock, and as soon as this happens the Federal government will have the power to elect the majority of members of our Board of Directors and, through them, the majority of members of the Executive Board, responsible for our day-to-day management. As a result, we

¹⁰⁴MPOG, "Orçamento Federal ao Alcance de Todos: PLOA 2013," p. 14, available at <http://www.orcamentofederal.gov.br/educacao-orientamentaria/ofat/ofat>

*shall have to get involved in activities that prioritize the objectives of the Brazilian Federal government, rather than our own economic and business objectives.*¹⁰⁵

The issue of the existing and growing gap between the prices of domestic oil and gas byproducts refined by Petrobrás and the prices of international enterprises and markets, due to government intervention, is an interesting aspect of the quasi-fiscal activities undertaken by the company. The current government policy on fuel prices is a central part of its economic strategy to curb inflation and to meet the determinations of macroeconomic budgetary regulations, and Petrobrás is the main instrument for its implementation. However, since the SOE acts within a market with private sector players, dynamics, and regulations, the government's policy faces a contradiction: sustaining the domestic oil and gas byproducts prices represents financial losses to Petrobrás and compromises potential revenues that will not be available to fund other necessary investments and to promote other public policies. The price adjustments require other financial mechanisms to keep the company's accounts in balance, which compose the intricate and indirect system of compensations created by the government.

In June 2012, for example, the adjustments of 7.83 percent for gasoline and 3.94 percent for diesel prices in refineries was offset by the reduction to 0 percent of the Contribution for Intervening in the Economic Domain (CIDE) related to the fuel market (CIDE-Combustíveis). This contribution has regulatory purposes and is charged to any producer (refinery), formulator (research facilities), and importer (person or enterprise) that imports or commercializes fuels.¹⁰⁶ Most of this revenue (71 percent) is paid to the federal government, and the remainder is divided between the states proportionally to the extent of their road system, the fuel consumption, and the population, to be applied to environmental programs to reduce the pollution and the negative effects caused by the fuels, subsidizing the purchase of fuels, and transportation infrastructure. Since Petrobrás still holds an effective monopoly over the refinement, importation, and transportation of petroleum in Brazil – exemplified by their ownership of 11 of the 13 large-scale refineries in the country – the company is the main contributor of revenue through CIDE. The recent reduction of this contribution represented for the company a waiver in the approximate amount of US\$209 million, though this is still not enough to offset the 15 percent gap created between domestic and international gasoline prices after the latest readjustments.

This policy has further contradictory impacts on the domestic fuel market and Petrobrás itself, when it comes to the production and commercialization of ethanol, whose competitiveness is undermined by the government control over the price of gasoline. According to the Sugar Cane Industry Reunion (UNICA), the federal government is promoting “dumping” in the fuel market when it encourages commercialization and grants fiscal incentives for gasoline production and sets its prices below the production cost, thereby imposing unfair competition on national ethanol production – of which Petrobrás is part – and discouraging the sugar and alcohol sector as a whole, even though there is a favorable context of a growing “flex fuel” automobile fleet in the country. The organization is leading a

¹⁰⁵ Petrobrás, “Relatório de Gestão 2011,” Julho 2012, available in TCU archives.

¹⁰⁶ Lei nº 10.336 de 2001 Article 3.

campaign to extend to ethanol the federal government incentives granted to gasoline production.¹⁰⁷ In another recent declaration, Petrobrás President Foster admitted that the current gasoline price affects ethanol's competitiveness and said that she believes that "as soon as its price becomes more attractive for those who invest in the sugar cane industry, the ethanol will have a strong comeback in the fuel market, which will be very much welcomed by Petrobrás."¹⁰⁸

On the other hand, these government interventions through price regulation and noncommercial undertakings by the company mean that Petrobrás is not obliged to assume any public service or duty as part of its quasi-fiscal activities. It does not suffer any discernible pressure from the federal government to set up basic public services and infrastructure in the communities affected by its activities, since there is a system of royalties and special payments distribution in place that results in a multimillion dollar payments from all the explorers and producers to these affected states and municipalities that is designed to enable them to invest in modernizing infrastructure, recuperating areas and equipment, and preventing damage. At the same time, these royalties and special payments transferred to states and municipalities offset the budgetary balance in several regions of the country, since this revenue often makes these federal units the richest per capita in the country.¹⁰⁹ As such, the quasi-fiscal activities undertaken by Petrobrás also include a dimension of the execution of the state's decisions on the location of the investments – when, for example, it is decided to install a refinery to benefit state A, to the detriment of state B. This often creates, sustains, or increases regional or interregional inequalities.

Petrobrás, in fact, makes a set of isolated investments of a public nature, but in the vast majority these do not call for compensations by the federal government, such as: 1) investments that take advantage of incentive regimes established by the national tax legislation, such as RENEPEC, and that are also open to private companies; 2) investments on the company's own initiatives, selected by means of invitations (or requests for proposals), as a way of sustaining the corporate image of social responsibility and competitiveness; and 3) investments for qualifying manpower, in particular allocated to the Program to Mobilize the National Oil and Natural Gas Industry (PRONIMP), in which the returns to the oil and gas sector are evident through the supply of skilled employees.

The Petrobrás Management Report for the Fiscal Year of 2011, prepared for the TCU to review, described the projects of quasi-fiscal activities sponsored by the company.¹¹⁰ These projects amounted to an expenditure of US\$349 million or 2.5 percent of what the company paid that same year in royalties and special participations to the federal government, the states and the municipalities. They are 1) Social Projects: US\$112.7 million; 2) Environmental Projects: US\$93.5 million; 3) Cultural Projects: US\$99.3 million; and 4) Sporting Projects: US\$43.6 million.

The report only specifies the line of action under each theme: "guarantee of children and teenagers' rights" and "education for professional qualification," the lines with more resources under Social

¹⁰⁷ "UNICA faz campanha pelo etanol," O Estado de S. Paulo, 11/09/2012, available at <http://www.estadao.com.br/noticias/impreso,unica-faz-campanha-pelo-etanol,957786,0.htm>

¹⁰⁸ TNOnline, "Petrobrás: gasolina afeta competitividade do etanol," 10/04/2012, available at <http://tnonline.com.br/noticias/economia/34,140111,04,10,petrobras-gasolina-afeta-competitividade-do-etanol.shtml>

¹⁰⁹ See SERRA (2005).

¹¹⁰ Petrobrás, Relatório de Gestão 2011, Julho 2012, available in TCU archives.

Projects; “recuperation or conservation of coastline, maritime and sweet-water species and environments,” by far the line with most resources devoted to Environmental Projects (with roughly 64 percent of funds), followed by “carbon fixation and avoided emissions” (13 percent); “production and diffusion” of Cultural Projects, which take up nearly 76 percent of the funds for this portfolio, followed by “preservation and memory” with 16 percent; and the Sporting Projects that are identified by program, such as “Esporte de Rendimento,” “Esporte Motor,” and “Programa Petrobrás Esporte & Cidadania,” of which the first includes over half of the resources.¹¹¹ As a comparison, the federal government has spent in the same year (2011) around US\$22.2 billion in the Social Assistance portfolio – not including the US\$176 billion spent through Social Security; US\$1.8 billion in the Environmental portfolio; US\$674 million in the Cultural portfolio; and US\$577 million in the Sports and Leisure portfolio.¹¹² These amounts do not include the expenditures in these areas made by states and municipalities.

3. Transparency and Oversight

Petrobrás, as a company in which the federal government directly or indirectly holds the majority of the voting shares, must be contained in the Enacted Budget under the state’s Investment Budget (OI). This section of the budget is prepared and organized by the Department of Coordination and Governance of State-Owned Companies (DEST), within the structure of the Ministry of Planning, Budget, and Management (MPOG). A brief, yet interesting, comparative document by DEST on the OI of SOEs can be found on the DEST website.¹¹³ It shows for the period 2006 to 2011 the consolidated expenditures through this budget by categories – the state Productive Sector (SPE), “Petrobrás Group,” “Eletrobrás Group” and “Others,” and the Federal Financial Institutions (IFF) – and the financial sources for these expenditures, such as own revenue, long-term credit operations, or funds destined to increase liquid capital. The document also illustrates the growth rate of expenditures made by the Petrobrás Group during the same years, which surpasses by far all other groups and categories, going from US\$13.2 billion in 2006 to US\$34.3 billion in 2011, while the Eletrobrás Group, which grew by the second-highest amount, went from US\$1.5 billion in 2006 to US\$3.7 billion in 2011. Every year, DEST issues an Overall Expense Plan (*Plano de Dispendio Global* – PDG) and the proposal for the Investment Budget, and aims to enhance corporate management of the SOEs. On this last point, it is interesting to note that it was the DEST that participated with suggestions in the preparation of the Guide to Corporate Governance of the OECD.¹¹⁴

On the entire budget (Social Security and Fiscal and Investment), DEST is required by the TCU to publish bimestrial financial balances of the budgetary execution of SOEs, which are available from 2000 through 2011 in the DEST website.¹¹⁵ For this research paper, we analyzed the bimestrial balance for 2011, published in January 2012, in which there was an overview of the SOEs, affiliates, and subsidiaries that included: 1) an overview of the OI, the cancellations and supplements of credits for

¹¹¹ Petrobrás, Relatório de Gestão 2011, Julho 2012, p. 60.

¹¹² Prestação de Contas do Presidente da República, *Year-End Report*, 2011.

¹¹³ Dados e Estatísticas.Orçamento de Investimento, Série Histórica, available at http://www.planejamento.gov.br/secretarias/upload/Arquivos/dest/serie_historica_120223.pdf

¹¹⁴ The Investment Budget (OI) of the SOEs is available on the web page of the General Comptroller Office (CGU), within each Year-End Report, available at: <http://www.cgu.gov.br/Publicacoes/PrestacaoContasPresidente/index.asp>

¹¹⁵ Dados e Estatísticas.Orçamento de Investimento, Dados Anuais, available at: http://www.planejamento.gov.br/link_secretaria.asp?cod=213&cat=310&sec=4&sub=295

that fiscal year by their authorizing laws, and the final endowments transferred in contrast with the amount actually executed by the beneficiaries; and 2) the discrimination of the investments by institutional ties (governmental office), by financial source, by function and subfunction, by program, and by geographical region.¹¹⁶ The overview points to the Enacted Budget as its main reference and the laws that later amended it, which totaled 79 SOEs in the OI, of which 72 are in SPE and 7 are IFFs. Of the corporations in SPE, 30 are part of the Petrobrás Group. The final budget available in the OI was around US\$49.5 billion to finance 392 projects and 290 activities.¹¹⁷

The investments in Petrobrás are visible in the table that illustrates the expenditures by governmental office/entity.¹¹⁸ Under the Ministry of Mines and Energy (MME), the Petrobrás Group received a final endowment of US\$41.9 billion, of which it has executed over US\$34 billion by the last bimestrial report of 2011, which represents 81.7 percent. The company itself is the main beneficiary, taking US\$28 billion of the final amount available and executing over 77 percent of it US\$22 billion over the year. This table also shows the amount appropriated for investments mentioned in this report, such as the Abreu & Lima Refinery, which executed all (99.9 percent) of the expenditures appropriated at US\$3.2 billion.

As for the yearly PDG also elaborated by DEST, it is also available on the DEST website, both in the form of consolidated data and discriminated by SOE.¹¹⁹ Both are simplified financial demonstrations for the period between 2006 and 2011 and disclose information on general expenditures (with capital or operational) and incoming revenue. Regarding Petrobrás, the PDG presents the balance in terms of assets, liabilities, and gross or liquid profits; and the expenditures are presented as payrolls, delegated services, operational and fiscal expenses, and investments in funds or programs, with no qualitative information. The indicators chosen include average expense per employee and their average yearly income and the percentage of the profit that is spent with operational expenses and delegated services.

The company itself offers a relatively broad set of documents and initiatives that provide information on its activities, to the point of receiving international approval for its budgetary and transparency practices, such as its inclusion for the past seven years in the Dow Jones Sustainability Index, in which Petrobrás obtained, six years in a row, the top score in the transparency criteria. Petrobrás also has a type of customer's relation or internal "ombudsman" service, which, over and above the traditional standards, maintains a channel for communication to be used by the company's workforce and is partly in response to the determinations of the U.S. Sarbanes-Oxley Act (SOxA), since the company is traded on the NY Stock Exchange. In addition, with regard to fighting corruption, the company's ombudsman service promoted, in 2011, the meeting of the Partnership Against Corruption Initiative in the context of the World Economic Forum (PACI-WEF).

¹¹⁶ Dados e Estatísticas. Orçamento de Investimento, Dados Anuais, 2011, Portaria do 6º Bimestre, January 2012, available at http://www.planejamento.gov.br/secretarias/upload/Legislacao/Portarias/2012/120130_port_01.pdf

¹¹⁷ Ibid., pp. 1-2.

¹¹⁸ Ibid., Tabs 6, p. 7.

¹¹⁹ Dados e Estatísticas. Programa de Dispêndios Globais (PDG), available at <http://www.planejamento.gov.br/secretaria.asp?cat=310&sub=189&sec=4>

The following set of instruments seeks to ensure good status for the company in terms of transparency, since they are all accessible through the Investor's Relations tab on the website:

- The Annual Sustainability Report;
- Financial Analysis and Financial statements;
- Code of Good Practices;
- Communications and Material Facts;
- Form 20F – as filed at the Securities and Exchange Commission (SEC);
- Reference Form – as filed at the CVM, the national stock market regulator;
- Information on General Meetings of Shareholders;
- Information on Dividends;
- Information on Costs and Taxes;
- Information on Production;
- Information on Proven Reserves;
- Frequently Asked Questions;
- Prospectus of Fixed-Yield Securities.¹²⁰

Risk factors are incorporated into several of the reports described above. In particular, the Annual Sustainability Reports contain a section devoted to environmental liabilities, and the Financial Analysis and Financial statements address the risks referring to indebtedness, lawsuits and contingencies in general and involving taxes; the risks associated with foreign exchange variations and variations in the prices of oil and derivatives; and the risks of potential operational catastrophes or misfortunes, such as the multimillion dollar indemnity charged by the Brazilian state due to the leak occurred in the a Southeastern field in November of 2011, which was operated by Chevron Brazil, in which Petrobrás holds a 30 percent share. The Financial Analysis and statements must be submitted to an independent external auditor chosen by the company's board of directors with the assistance of the internal audit committee. The independent external auditing firm cannot render any other services for Petrobrás and must be changed every ten years if done so consecutively, as determined by the CVM. Annually, an abstract of the report on financial statements by the independent auditor is published alongside the report itself.

In contrast to these positive practices, the clear disclosure of the remuneration of the board members – rendered an important positive transparency practice by the OECD Guidelines (2010), – is not fully respected by Petrobrás. With regard to the board members' remuneration, Petrobrás publishes on its site only the annual maximum limits stipulated by the General Meetings of Shareholders. Faced with this possibility given by the decree that regulated the Law for Public Access to Information of not disclosing their payroll, Petrobrás opted not to publish on the website any data referring to salaries, benefits, cost-assistance, and fees. It is important to note that this is not possible for the direct

¹²⁰ Petrobrás. Relacionamento com Investidores, available at <http://www.investidorpetrobras.com.br/pt/home.htm>

administration – the government’s main body, which is required by law to publish online the individual payrolls for all public servants on their Transparency Portal.^{121, 122}

Oversight from within the executive branch occurs through the National Petroleum Agency (ANP), as already explained, and through the General Comptroller’s Office (CGU), which also examines Petrobrás’ annual Management Report, which is submitted to the TCU, among other documents. Its oversight actions can be seen in a recent report published by the CGU pointing to irregular transfers amounting to US\$1.3 million in contracts between the company and ONGs located in the same state as the Petrobrás’ president between 2004 and 2006.¹²³ According to CGU, Petrobrás would have transferred the funds to the ONG without enforcing the necessary accountability and transparency practices, such as balances and reports on finances and activities.¹²⁴

Oversight of Petrobrás, as an SOE, is exercised by the legislative branch in several ways, both directly through congressional commissions and indirectly through the independent office of the TCU. For example, the Mixed Commission of Plans, Budgets, and Inspection (CMO), responsible for examining and officially commenting on all key budget documents – the multi-year plan for the government, the Pre-Budget Statement, and the Enacted Budget – has noted irregularities in the federal budget for 2011 on the project titled “Modernization and Adaptation of the Presidente Vargas Refinery – Repair,” owned by the Petrobrás Group and listed as having consolidated signs of serious irregularities, rendering its shutdown.¹²⁵ These considerations must be taken into account in the Enacted Budget, as determined, for instance, in the Pre-Budget Statement for 2013, namely the “provisions on inspection by the Legislative Branch and of ventures or services with signs of serious irregularities,” including updated information on their correction or cessation, or, if not the case, the pertinent justifications.¹²⁶ The irregularities identified by the CMO are crucial especially for stakeholders’ knowledge, since they have the power to influence investment decisions and to force some kind of commitment from the company to potential solutions and may stain their corporate image.

The TCU, whose external control secretariats are usually located in the capital, Brasília, has an extraordinary office (the Ninth SECEX) in Rio de Janeiro, where Petrobrás flagship offices and many of its activities are located, and which can facilitate the entity’s oversight of the company’s operations. The

¹²¹ Decree nº 7.724 of 2012, Article 5, §1º. The decree determines that the SOEs that act under competitive conditions are subject to norms established by the CVM, so that their competitiveness, corporate governance, and minority shareholders interests are protected.

¹²² “Estatais aproveitam brecha em legislação e não divulgam salário na web,” *Correio Brasiliense Online*, 03/07/2012, available at http://www.correiobrasiliense.com.br/app/noticia/politica/2012/07/03/interna_politica,310287/estatais-aproveitam-brecha-em-legislacao-e-nao-divulgam-salarios-na-web.shtml

¹²³ Federal Constitution of 1988, Article 70: “The accounting, financial, budgetary, operation and property inspection of the Federal Union and entities of the direct and indirect administration, as to legality, legitimacy, economy, the application of subsidies and relinquishment of revenues, will be exercised by the National Congress, through external control, and by the internal control system of each Branch.” And, “Sole paragraph. Any natural person or legal entity, public or private, who uses, collects, keeps, manages or administrates public moneys, assets and valuables or for which the Federal Union responds, or who, on behalf of the latter, assumes monetary obligations, shall render accounts.”

¹²⁴ “CGU aponta desvios de R\$2,8 mi em contratos da Petrobrás,” *Folha de S. Paulo*, 02/18/2012, available at: <http://www1.folha.uol.com.br/poder/1050552-cgu-aponta-desvios-de-r-28-mi-em-contratos-da-petrobras.shtml>

¹²⁵ The CMO’s list of ventures or services with signs of serious irregularities in the fiscal year of 2011, available at <http://www.camara.gov.br/internet/comissao/index/mista/orca/qts/2011/qts2011.pdf>

¹²⁶ See the Pre-Budget statement for 2013, Lei nº 12.708 of 2012, Article 1º, IX.

annual Management Report prepared by Petrobrás for the TCU's inspection is the richest among the mentioned transparency instruments made available by the company; by virtue of a series of normative decisions (especially n° 108/2010) issued by the TCU, this report grew to contain extensive information, resulting in a 449-page document for the year 2011.¹²⁷ Other than these, oversight is also exercised by other official entities, such as the Counsel for Stock Market Values (CVM) and the Federal Revenue Bureau of Brazil (RFB), though the Special Coordination for Monitoring the Large-scale Taxpayers (COMAC).

4. Social Control and Participation

Although there is virtually no social participation in the company's decision process, there are some social organizations in Brazil that are directly involved with observing, commenting on, and participating in debates, decisions, and protests in the area of oil, gas, and fuels in general. Associated to the Amnesty International and with ties to the Syndicate of Petroleum workers of the producing state Rio de Janeiro, the News Agency of Petroleum (APN) is one organization that uses civil or social channels to promote their interests. An example is the campaign "The Petroleum Must Be Ours" and its protests, which defend the maintenance of the government monopoly of the oil exploration, acting against auctions and concessions of potential reserve blocks.¹²⁸ Other attempts at social control over the company's activities can be seen in the environmental organizations and their manifestations, such as the recent one against the pollution of the ocean during oil exploration ventures and the improper use or waste of water.¹²⁹

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¹²⁷Petrobrás, Auditoria, Yearly available at <http://www.petrobras.com.br/acessoinformacao/auditorias/>

¹²⁸APN, "Campanha 'O Petróleo Tem Que Ser Nosso' Faz Ato em Frente à Petrobrás," 10/03/2012, available at <http://www.apn.org.br/w3/index.php/40-manchete/urgente/5026-campanha-o-petroleo-tem-que-ser-nosso-faz-ato-em-frente-a-petrobras>

¹²⁹ "Ambientalistas fazem protesto contra a Petrobrás, no Rio," *Jornal do Brasil Online*, 10/02/2012, available at <http://www.jb.com.br/ciencia-e-tecnologia/noticias/2012/10/02/ambientalista-fazem-protesto-contra-a-petrobras-no-rio/>