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The Role of the Federally-Owned Banks in Brazil

By Jaime Herzog

1. INTRODUCTION

The current world environment has raised many questions concerning the role of state-owned organizations in the success or failure of national economies. Events such as the German reunification and the fall of many communist economies of the former Soviet Union, and the economic turbulence that is taking place in Asia, are contributing to the pro and con arguments of this issue.

Whatever the country, freedom is one of the most important goals for every human being. Likewise, the ideal economic environment is one where the real free market comes up with equality opportunities for everyone. Nevertheless, in the actual world this environment is a utopia for most of the nations and governments, being only one long term goal, sometimes less important than many other ones, such as to proportionate a minimum welfare or, even in some cases, survival conditions for the population.

Whatever the governments' power and the influence in their countries, the most successful models are the ones best adapted to their historical circumstances and the cultural, political, demographic, social or economic characteristics of the countries that adopt them. Evidently, such models also take into account strategies to increase their influence to other nations, looking for keeping privileges, reducing limitations and for perpetuate other countries as peripheral economies.

The goal of this work is to advocate that one country like Brazil must not give up its state-owned financial system. The work also proposes ways that allow federally-owned banks to foster the prominent role that

historically have been played in the Brazilian development.

2. GLOBAL VISION vs. LOCALIZED VISION

Globalization of markets is a relatively recent phenomenon, taking force over the past decades. It seems that this is the relentless destiny of the planet, as well as it went in the change from the individual way of life to the relative, from the relative to the tribal, from the tribal to the urban, from the urban to the national etc.

Anyway, like what it seems, there is no international consensus for the advantages of globalization. The political scientist Ignacy Sachs, for example, advocates a new development model to the Latin countries where they should avoid globalization, whose presuppositions don't mean a recipe that can be indiscriminately applied at any nation.

Another scholar, John Williamson, has surprised the audience in a recent seminar when he supported changes in the ten rationales pointed by himself in the so-called "Washington Consensus" (1989). In his vision, it became crucial the creation of instruments that facilitate a better management of the economy, that cannot be exclusively submitted to the "rules of the market". He has also specifically pointed that it is necessary to increase the control on the banking system.

In fact, no development strategy can overlook the power of global markets. Despite this, paradoxically, nations are organizing themselves in economic blocs in order to optimize their competitive advantages. It means, in behalf of competitiveness in a globalized world, economies aim to protect themselves in regional blocs.

Nevertheless, once there are big unevenness among the blocs as well as intrablocs, the more powerful trade blocs are also far better positioned concerning the others. It leads to conclude that such unevenness will remain still in the long run.

Indicator	Argentina	Brazil	Chile	Colombia	Mexico	Peru	Uruguay	Developed Countries	LAC
Population (thousands)		150,368							
Population Growth (%)	1.3	2.1	1.7	1.7	1.9	2.2	0.6	0.5	1.9
Urban Population (%)		74.9							
Dependence Rate	0.64	0.66	0.57	0.65	0.69	0.71	0.59	0.49	0.68
Gross Birth Rate		26.7							
Gross Fertility Rate	2.82	3.20	2.52	2.66	3.30	3.80	2.28	1.72	3.30
Infant Mortality Rate		57.5							
Life Expectancy at Birth	71.2	66.2	72.0	68.8	69.7	62.7	73.0	80.1	67.6
GNP per Capita (US\$ 1992)		2,770							
Labor Force (%)	35.1	36.6	36.6	32.7	34.3	32.0	38.9	48.0	35.2
Female Labor Force (%)		20.0							
Persons per Physician	374	1,080	1,230	1,228	1,240 ^a	1,041	513	-	936
Primary School Repetition rate (%)		19.4							
Illiteracy Rate (age 15 and over, %)	4.7	18.9	6.6	13.3	12.7	14.9	4.3 ^b	-	15.5
Secondary School Coverage (%)		39.0							
Poor Urban Households (% , 1990) ^c	25	39	34	35	34	45	10	-	39

The table shows how big and important can be such a problem for developing countries either inter or intrablocs. For instance, in a same economic bloc can be found one country that is considered the richer and the most powerful in the world, that mean USA, and another which the population's life expectancy is about ten years less, the infant mortality rate is almost three times bigger and the GNP per capita is around 15% of the developed countries average. Even so, this country (Mexico) is by and large better than the average of the Latin American countries, as can be seen also in the following table.

Even countries better adapted to globalization of markets remain closed with regard to many aspects, for example demographic mobility. Thus, even in a globalized environment, with big economic and financial interdependence worldwide, a great part of the social problems of the countries likely will be bounded them.

Likewise, concerning several national aspects of development, the conjunction between current regional unbalances and the application of an economic model that advocates the free market being applied at once and without any degree of interventionism can lead to the crystallization of the social disparities. It is important to underline this aspect particularly regarding to the countries that have the most unfair social indicators, case of Brazil. For example, the Gini ratio in Brazil is one of the worst of the planet: the poorest 20% of the Brazilian population earn only two percent of the national income, while the wealthiest 10% receive around 50%.

The most remarkable difference between internal and external unbalances is that, in the case of a country, there is one central government that aims, among other important goals and responsibilities, to foster the harmonic and effective operation of the markets.

Governments must also promote the balanced progress in order to a larger number of inhabitants be at the same time agents and beneficiaries of it. Nevertheless, each society must define how that role will be played by the governments, taking into account their own characteristics and needs.

It is also crucial to govern using a global holistic vision. This vision must aim to manage the public action in order to improve the population's welfare and not the opposite. So, each country must define what is "Minimum State". I believe that it never must be so big to harm the execution of the private enterprises' missions. On the other hand, the State must govern using necessary means for accomplish his long run strategic goal, maximizing the use of the nation's scarce financial resources to accomplish their needs.

In this point, it worth thinking a little on what would be "long run". The turbulence that has occurred in Brazilian recent history shortened the periods of time usually defined as long, medium or even short run with regard to the other countries. Thus, what would usually be described as medium or short run in developed countries is usually named long run in Brazil.

However, the stability of prices reached with "Plano Real" has created a favorable atmosphere for rewidening temporal dimensions. Thus, it is becoming possible again to actually think in the long run. And it could mean, for example, 50 years concerning development policies.

3. INTERVENTIONISM vs. LIBERALISM

Although the best development model is the one that offers freedom to the economic agents (therefore, the fewer regulated), the very success of one economic model must be analyzed through his behavior in the long run. In fact, it is too soon to assure that development models that advocate total deregulation are the only successful way to assure progress in a global sense.

Thus, there are no reason for uphold the end of the governmental direct action on all production means. On the contrary, many development programs that had been mentioned in Brazil as successful examples take place in countries which have high levels of state intervention, even having in their public policies one of the most decisive factor of their success.

Therefore, it could be said that passionate defenses of a fast and radical privatization program in Brazil are common sophisms in "adolescent countries", once they look (for example) for the speed of economic growth of the "Asian Tigers" advocating the adoption of liberal practices as observed within United States of America, thus overlooking each nation's particularities.

From this standpoint, general rules of economic liberalism applied all at once and indiscriminately in developing countries can be useful for the developed countries, once it favors the maintenance of an environment where some developing countries aren't capable to exploit all there potentialities, keeping themselves as peripheral nations.

So, the very economic liberalism in the more primitive form wouldn't be advisable for nations as Brazil, whose potential of internal consuming market and the abundance of resources could transform it in the long run in one of the few nations – besides countries like China – capable of competing with the western European countries and United States of America.

It doesn't mean that we must overlook competition. On the contrary, it's crucial to stimulate the free market as well as to avoid the monopolies and oligopolies. Nevertheless, some sectors of the Brazilian economy, as banking, deserve a closely governmental action in order to avoid the growth of the income concentration through regions or social classes.

Besides this, it is crucial to make the enforcement as good as possible in order to avoid some common problems in developing countries, as frauds and mismanagement of resources.

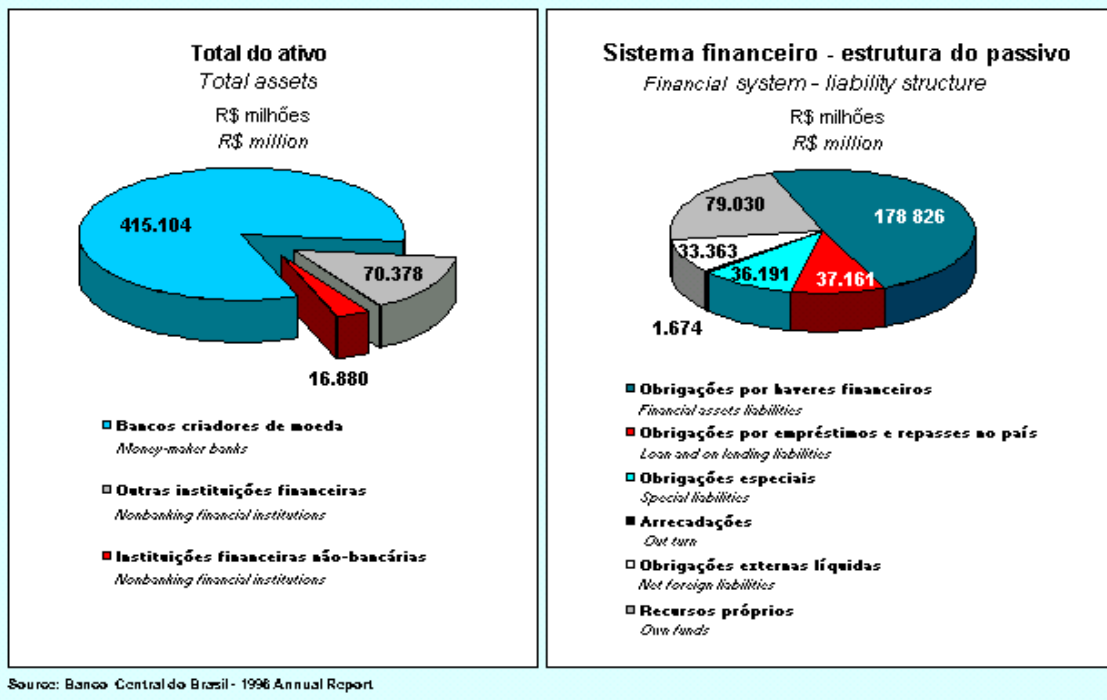
4. BRAZILIAN FINANCIAL SYSTEM

With more than two hundred institutions, the Brazilian financial system can be considered the biggest and most complex of Latin America, as shown below. Even so, the laws that regulate the system (law #4595, from 12/31/1964) can be considered old-fashioned, since there were many adaptations and the world has changed very much in the last 33 years. Regarding this, Brazilian Federal Constitution, issued in 1988 determines that "the national financial system (...) will be regulated in complementary law". Nevertheless, since this is a very controversial matter, it has been difficult to deal with this matter. So, there were no law passed so far.

Instituições autorizadas a operar pelo Banco Central do Brasil						
<i>Institutions authorized by the Banco Central do Brasil to operate</i>						
Tipos de instituições	1992	1993	1994	1995	1996	<i>Types of institutions</i>
Instituições com carteira comercial						<i>Institutions with commercial portfolios</i>
Bancos comerciais	36	34	35	35	37	<i>Commercial banks</i>
Bancos múltiplos	175	182	193	198	195	<i>Multiple banks</i>
Total	211	216	228	233	232	<i>Total</i>
Instituições com carteira de investimentos						<i>Institutions with investment portfolio</i>
Bancos de investimentos	20	17	17	17	23	<i>Investment banks</i>
Bancos múltiplos	101	105	115	115	110	<i>Multiple banks</i>
Total	121	122	132	132	133	<i>Total</i>
Instituições com carteira de crédito, financiamento e investimento						<i>Institutions with credit, financing and investment portfolio</i>
Financeiras	41	42	42	42	47	<i>Financial institutions</i>
Bancos múltiplos	158	165	174	179	172	<i>Multiple banks</i>
Total	199	207	216	221	219	<i>Total</i>
Inst. com carteira de crédito imobiliário						<i>Institutions with real estate credit portfolio</i>
Credito imobiliário	26	8	7	21	20	<i>Real estate credit</i>
Bancos múltiplos	78	82	80	78	79	<i>Multiple banks</i>
Total	104	90	87	99	99	<i>Total</i>
Inst. com carteira de desenvolvimento						<i>Institutions with development portfolio</i>
Bancos de desenvolvimento	9	8	6	6	6	<i>Development banks</i>
Bancos múltiplos	15	15	18	18	20	<i>Multiple banks</i>
Total	24	23	24	24	26	<i>Total</i>

Source: Banco Central do Brasil - 1996 Annual Report

Sistema Financeiro Nacional
National Financial System



Nowadays there are several questions about the Brazilian banks' contribution for national economic development. Actually, one of the most outstanding characteristics of Brazil's banking system has been the great potential of adaptation to the volatility of the national economic conjuncture in recent years.

The Brazilian banks have been perhaps the largest beneficiaries of the high inflation rates occurred until 1994, which allowed them to earn important and safe profits with the so called "inflationary float".

For a long time banks overlooked credit to productive activity in favor of financing governmental fiscal deficits distancing from their main objective, which is to "improve the balanced development of the Country". In fact, as the opposite of many regions, Latin America usually doesn't have a big proportion of credit loans relative to GDP, as shown below.

One of the probable reasons of this situation is the inflationary history of these countries in recent years that make the credit loans more risky than in other parts of the world. Other reasons could be the economic crisis as a hole and the lack of sophistication in some countries' financial systems.

According to some scholars who deal with the Brazilian financial banking system, it tends to be subdivided into three distinct branches: retail (with a few and very large institutions), investment (with a few and highly agile institutions) and specialized (in vehicle sales, e.g.).

The number of institutions tends to diminish while the size of the system will increase, since it will have to accompany the process of economic growth and, therefore, will have to provide banking services to an increasingly larger array of people and businesses.

Besides the process of mergers and acquisitions and the reduction in the number of banks, there will be a utterly new reality in the financial sector including cheaper credit for the population and more sophisticated ways to grant credit to the economic agents. Chances are that the financial system as a whole will have been restructured by the next decade in order to be better adapted to the current times.

5. BANKING IN BRAZIL REGARDING PRICE STABILITY

The role of the banks must not have as presupposition to limit actions but to support the development of the country, chiefly fostering increasing credits to the economic agents. So, besides the search of profits, the role of a financial system is also to look for socio-economic results in the long run.

"Plano Cruzado" has already signaled that the economic environment would change sooner or later. And, when it changed, the absence of the inflationary gains would reveal the banks' inadequacy and unpreparedness to deal with a situation of price stability and of return to the direct financing to the production of goods and services.

In the following eight years, several banks have adopted strategies in order to lead them up to new times. Thereupon, great part of the national financial system is coming up with the same level of profitability with regard to the last "mega-inflacionary" years. It is important to say that "Plano Real" has been using extremely restrictive monetary policy that turned the credit scarce and hence increased the level of default credits.

Nevertheless some banks had shown unequivocal difficulties to get along with the new environment that lead even to the reduction of the Brazilian financial system, leading the Federal Government to act in order to avoid that the negative impacts of the troubles in the Brazilian financial system would spread throughout the economy. Among them, two of the most important were the "PROER" and the Brazilian financial system openness to foreign banks, some of that with assets bigger than the ones of all Brazilian financial system.

1. PROER:

The launch of PROER (Program for The Restructuring and Strengthening of The National Financial System) was one of the solutions to relief the liquidity and solvency problems faced by the Brazilian financial system. One of the goals of PROER was to stimulate mergers and acquisitions through tax benefits and concession of a special line of financial assistance.

Another goal of PROER was to promote changes in the Brazilian legislation in order to allow Banco Central do Brasil to intervene whenever the private banks did not comply with requirements or faced major financial problems. From the launch of "Plano Real" until the first quarter of 1997 the Brazilian central bank intervened in 37 institutions (30 private and 7 public) and borrowed around U\$ 20 billion in order to facilitate the recovery of these financial institutions. This amount is not so high, if compared with other countries.

The figure shows that, if compared with other countries, such amount can be considered relatively small. It is important to underline that Latin American countries has had larger costs of adjustment than in other countries. For instance, the share of GDP released for Chile is around four times the one released in Norway, Sweden and USA. It is also important to remark that this chart doesn't include the consequences of the recent crisis in some Asian Countries over their financial systems.

Anyway, it is also important to remark that governments usually have to act directly aiming to avoid crisis that could be stretched throughout the economy as a whole.

2. STATE BANKS:

Besides the PROER, the Brazilian government enacted in 08/08/1996 a bill that aimed to motivate the reduction the in state-owned public banks' share in the financial activity, looking for a long run solution for the problem: It establishes:

- privatization, transformation in non-financial institution or fomentation agency with subsidy of the federal Government;

- Strengthening of the bank by the state Government, an option which it will be charged 50% of the costs of the operation, besides to demonstrate fiscal capacity to answer for the commitment. The Union, in this case, borrows the 50% remaining, since there is a restructuring project;
- Take over of the state bank by the Union, exclusively to prepare for privatization or to extinguish it.

Therewith states that are in better fiscal situation tend to allocate capital in their institutions. On the other hand, those states that are in financial difficulties tend to opt for the transformation in fomentation agencies. Since the most of the states are in that last condition, chances are that this will be the most likely fate for these institutions.

There is also the possibility of privatization or even extinction. Nevertheless, state governments aren't by and large favorable to the privatization of their banks.

1. SOME OTHER FINANCIAL SYSTEMS' EXPERIENCE:

This section evaluates some other countries' experience, chiefly those who passed through banking crisis or processes of stabilization similar to the Brazilian, as Chile and Venezuela.

1. CHILE

The Chilean economic reforms are usually considered as successful example, mostly in Latin America. They began very early, in the 1970's, when the political environment was very different from the current one in Brazil. At that time, the low level of economic openness was one of the more remarkable characteristics of the Chilean system. The lack of external competition was responsible for the low degree of productivity in several economic sectors.

The Chilean financial market, besides relying on legal barriers to the entrance of foreign institutions, was excessively regulated. Negative interest rates and quantitative controls to the credit concession are examples of the limitations of the banking system.

In 1970 there was one public commercial bank - the Banco del Estado - and twenty-seven private banks (five foreign). Other public and private financial institutions has also acted, as mortgage banks, saving and loan associations and credit cooperatives. In the first three years of that decade, State increased their participation in the sector through interventions or "statizations". The number of institutions dropped from 28 to 22, due to some mergers, liquidations and also to discontinuations of activities of foreign banks.

Since 1974, with the implementation of the reforms, the financial system strengthening was prioritized, being recognized the important role that it could carry out in the restructuring of the Chilean economy. The financial system had been gradually deregulated, reducing or eliminating restrictions to credit concessions. In a second stage the banks that had suffered intervention returned to their owners and the ones that had been statized were privatized.

Until 1980, the Chilean economy moved forward in the restructuring process, having consolidated several other reforms, besides the one that strengthened the financial system. One of the reasons of that invigoration, however, were the high inflation and internal interest rates.

Once the companies in general have maintained low capitalization levels the crisis that reached the Chilean economy in the initial years of the 1980's was severe both in the productive and in the financial sector.

Like Brazilian Government, the Chilean Government also had an active role in the preservation of the banking system, starting from the middle eighties. The performance of the "Superintendencia de Bancos" - that, together with the Chilean central bank, is in charge of the control of the financial institutions – was remarkable in the recovery phase as well as in the maintenance of a solid system.

In summary those actions, conjugated to the global economic performance, resulted in the stabilization of the Chilean financial system, after an adjustment period of some liquidations and interventions. The Banco del Estado has remained as the only public bank.

2. VENEZUELA

This country was involved in a serious banking crisis a few years ago. In a general way, there was a climate of political instability as a result of two coups d'état attempts that happened in 1992. The unstable conditions of the economy discouraged investments, depressed the level of economic activity and the international capital began to leave the country.

In this environment the banking crisis broke out in 1993. The intervention in the second commercial bank in deposits of saving - the Banco Latino - in February was the starting point. In the total 19 commercial banks - one half of the Venezuelan bank system - and their associated companies were in serious difficulties. Those banks had the same fate of the Banco Latino.

The banking crisis worsened the health of the economic system as a whole, contributing to the 3,3% fall of GDP in 1994. The growth of just 2,0% in 1995 was accomplished by virtue of the performance of the oil sector. There was big inflationary stress, followed by control of prices period (from 2nd half of 1994 to 1st half of 1995) that lead to internal shortage of goods and services. Unemployment was increased, reaching unofficial level of 18%.

The government faced this serious crisis aiding financially the banks in difficulties and worsened the fiscal deficit. In 1994, it reached 15% of GDP, nullifying the benefits overtaken through the tributary reform that was being implemented.

A variety of factors directly related to the financial system were also decisive for the crisis depth. The main were: weakness of the capacity of supervision of the Superintendencia de Bancos; antiquated legal system regarding to the financial activities; growing political interference; mismanagement, overlooking the seriousness and length of the crisis.

The Venezuelan experience confirms the viewpoint that the health of a financial system depends on the general performance of the economy as well as on the efficient bank supervision.

3. ARGENTINA

The Argentinean banks has experienced problems as a result of the turbulence originated by Mexican crisis. At the end of 1994 there were massive withdrawals from deposit accounts. The structure of deposits changed during the crisis: in August 1995, the five most important institutions in deposits (Banco de la Nación, Provincia de Buenos Aires, Galicia, Río de la Plata and Citibank), held 47.1% of the total ones, while in December 1994 they held 36.3%.

As a result, The Argentine government took several steps in order to avoid the aggravation of the situation. Among them, the launch of a deposit insurance mechanism, the encouragement of mergers and acquisitions and the institution of a fund to capitalize banks, initially financed by an issue of three-year government securities.

Thereupon, the number of banks that operated in Argentina decreased. In December 1994 the financial system was made up of 205 institutions: 33 state-owned banks, 135 private banks and 37 non-banks. Private banks included 66 corporations of domestic capital, 31 foreign banks and 38 cooperative banks. The state-owned banks held 39% of total deposits, private banks, 60% and non-banks the remaining 1%.

After the changes in the financial system during the first half of 1995, the number of institutions had declined to 162 in October. Of that total, only 10 certificates were cancelled and the remaining 33

cases derived from 14 mergers and acquisitions embracing 47 institutions. After these changes, the financial system was made up of 31 state-owned banks (of which 25 are provincial and municipal banks), 101 private banks (60 corporations of domestic capital, 31 foreign banks, 10 cooperatives) and 30 non-banks. The greatest reduction took place in the cooperative segment (28) and non-banks (7), which were the most severely affected by the withdrawal of deposits during the first six months of that year.

This process of bank restructuring generated improved levels of competition and efficiency in the sector. The profitability of financial entities was increased as the net financial margin rose against administration costs, the performing loan portfolio increased as a proportion of the total and the deposits to personnel ratio improved. These indicators have been particularly positive in the case of financial entities in the private sector.

The crisis in Southeast Asia that affected the main stock markets worldwide has increased the Argentinean country risk premium. Nevertheless this external shock has had relatively little impact on the local financial system (there were only increases in lending rates and call money). In fact the financial system today is at its healthiest since the "tequila crisis".

Since the beginning of 1996 and until the third quarter of 1997 deposits and loans have risen, setting new records. In November total deposits rose by U\$ 1,951 million, reaching a level 24% higher than in the same period of the previous year. The only effect of the crisis on deposits has been slight growth in the share of dollar deposits, which account for 54% of the total.

4. GERMANY

The financial sector has been one of the most dynamic of the German economy. With great capacity of diversification of activities, opened to innovations, solid capital basis and high efficiency, this sector has experienced an outstanding growth rate. The share of the bank services in GDP grew from 1,8% in 1960 to 2,6% in 1970, 3,6% in 1980, nowadays being above 4%.

In Germany, 60% of the financial transactions with foreign countries are made through banks while in United States of America only around 30% of these operations are intermediated by the banking sector. In the same way, the German banks supply about 45% of the whole venture capital, while in United States this index is around 10%.

The efficient administration of costs, associated with a stable economic situation, has been differentiating the German financial sector and placed it in a privileged position. This situation has also been facilitated, besides the extinction of fees and legal barriers to capital transactions, because Germany is an important financial center.

The great challenges have been the maintenance of a competitive banking system, integrated to the eastern region, regarding to the German reunification in October, 1990 and the preparation to act in the European common market, concerning the German strategic position as a connection link between Eastern and Western Europe.

Another characteristic of the German financial system is that there is an excessive but declining number of banks within the country. That process began in the 1950's, when there were around 14.000 independent banks, a number that has lowered to 4.500 in 1996. These mergers and acquisitions tend to continue during the next years, chiefly among the small and medium banks, while the largest ones will be looking for the international market.

The German banking network is one of the worlds most integrated and well distributed. In 1994 there were 331 commercial banks (big banks, regional banks, private banks, foreign banks), 13 central saving and working capital banks, 643 saving banks, 4 regional cooperative central banks, 2.660 credit cooperatives, 33 mortgage banks, 30 housing loan societies, the postal bank and several

other banking institutions with specific functions. In the total, the sector employ about 500.000 workers, distributed over more than 53.000 branches, which represents a high average of one bank office for each 1.500 inhabitants.

The legislation is also very flexible, allowing a close relationship between banks and other economic segments, chiefly the industry. It is estimated that around two thirds of the 100 larger German companies have at least one representative of the banking sector in their administration councils. This allows the large banks to influence the companies' internal decision process and hence to better monitor the loans, since the risks become smaller. On the other hand, this situation increases the tendency to privilege large enterprises, in which large banks has some kind of influence, regarding other. Thus, public banks and cooperatives play an important role offering credits and services to segments neglected by large commercial banks.

Concerning the property, the German financial system presents a mix of private institutions (30%), public (50%) and cooperatives (20%). Besides this classification, the sector can be classified by activity in universal banks and specialist banks. However, such differentiation has no big importance, since there are no very different commercial objectives the way it was in the past. The reality has been showing that, in a general way, the operations and the objectives of the banks have more similarities than differences, what can be credited to the growing competition among them.

5. NORDIC COUNTRIES (Norway, Sweden and Finland)

In these countries, governmental concerns with the possibility of a bank crisis resulted in various alternative solutions. Liquidation is a rarely used instrument, applied only to small institutions.

One alternative has been the sale through a "Purchase and Assumption Agreement". These agreements can take the form of a "bank as is" agreement or a "reorganized bank" agreement. In the first case, all the assets (including low quality assets) and all the liabilities are transferred to the buying institution. Control remains within the private sector, thus strengthening the incentive to reorganize.

The government also provides a line of assistance and can receive guaranties convertible into stock. The result is potential participation in the future profits of the institution. Since as a matter of fact it is difficult to define the value of bad assets, it is also very difficult to specify the value of the needed assistance. In this case, the authorities may provide "coverage for capital losses" or, in other words, they can issue guaranties for the low quality assets that remained on the institution's balance sheets or they can offer "permanent payments" for bad investments.

The option of the "reorganized bank" in the purchase and assumption agreement makes it possible for the acquiring party to assume all the liabilities and none of the assets (or, at least, none of the bad assets). These are transferred to another bank, designated the "bad bank". The hypothesis here is that a single institution that is specialized in bad assets will be more efficient in the task of recovering maximum possible value. From the point of view of the acquiring party, separation of the assets increases the incentive for concluding the transaction since risk is reduced, at the same time in which, once the operations has been worked out, the healthy institution will be capable of obtain improved levels of performance without constant government interventions. Yet, the Government must pay for costs, losses and bad assets retained.

2. THE PRESENCE OF FOREIGN BANKS IN BRAZIL

Back to Brazil, another fact that has been exciting the financial system is the increasing interest by foreign banks in operate within Brazilian boundaries. The boom of foreign direct investments in the Brazilian financial system has raised arguments around its micro and macroeconomic consequences. Looking for the reliability and modernization of the local financial systems, emergent economies usually open and deregulate its financial markets in order to attract institutions as insurance companies, brokers and international banks.

Brazil, formerly blamed because of his closed economy and the lack of clear foreign financial institution regulation, is booming by integrating the international financial circuit. Some features, like the size and potentiality of his internal market and the current high interest rates are some of the attractiveness that make Brazil one of the largest destinations for big international financial institutions.

With the Brazilian prices stabilization and the acceleration of the financial deregulation process, the interest of the foreign banks in settling in the Brazilian market has been increasing quickly. Therewith Government tries to take advantage of this situation fostering the modernization of Brazilian markets through the encouragement of the ingress of international banks. This new approach has been motivating the entrance of the foreign direct investments in the financial sector.

The following figure shows how increasing has been the presence of foreign banks in Brazil since the launch of "Plano Real" (1994). Both assets, credit loan, equities and profits have experienced an important increase from this date on.

The growing share of foreign financial institutions has rising polemics concerning the benefits and costs of an internationalization of the Brazilian financial system. It is speculated that the competitive advantages of foreign banks could weaken the system as a whole, as well as the economy. Some specialists warn that the current lack of modern supervision methods, beside the growing speed and volatility of the international capital flows, could increase the risk of loss of effectiveness in the traditional internal instruments of monetary policy.

As can be seen in the following figure, of participation of the foreign banks in Brazil is less than the one existent in some other countries, like Argentina and Chile as well as these countries' level is far away from the one reached by countries like United States of America. However this very argument don't mean that Brazil, based on the experience of another emergent markets, should increase abruptly the share of international financial institutions.

Beside this, there is no world parameter for a speed of a financial system deregulation just because countries are different from one another. Neither is there a world parameter for the speed of the openness of a financial system. If, on one side, the presence of the foreign institutions allows the modernization and increases the competitiveness of the local market, on the other it can generate predatory competition that can worsen the current structural problems of the Brazilian economy. Thus the strategy of conduct of internal economic policy and the effectiveness of the instruments of regulation and supervision, as well as the peculiarities of each country, must determine the appropriate moment, speed and level for liberalization and deregulation of the financial systems in order to maximize benefits and minimize costs.

3. THE ROLE PLAYED BY THE STATE-OWNED BANKS

Concerning the public sector, factors as little flexibility and political hindering has made the problem of the banks particularly bigger, even though the most part of such political interference was motivated by germane reasons and not by issues considered "opposed to the Brazilian interests".

Anyway, the state-owned banks fell behind in the adaptation process. This fact has been contributing to questions about their actual importance in the Brazilian development, many times through precipitate and superficial approaches that takes in consideration more the current situation than the long run effects on the national global development.

Many technicians believe that state-owned banks should be closed or privatized, arguing that private banks can accomplish their functions more efficaciously. According to them, the operations that aim to reach governmental priorities should be executed through previous budgetary endowments.

Such analysis can be considered superficial because it doesn't take into account some factors, including income concentration among regions or people. Thus, in one bank that has as goal to maximize profits, the cost of opportunity of some kinds of operations, chiefly "in the government interest", can make them

uninteresting or expansive: Uninteresting, if governments are not willing to pay the amount charged; expansive, if governments choose to pay.

Nevertheless, state-owned banks can charge cheapest fees depending upon how important is each operation, considering governmental interest or even their own mission, once they must not have as main goal to maximize profits but obtain results that quest, at the same time, to maintain their survivability - that is, maintain liquidity, capital and some profits - and to foster the national development.

In fact, this might be the great difference between private and public banks: Private bank tends to maximize financial results; On the other hand, public institutions considers profits necessary but not the only condition for their "modus operandi", tending to have important auxiliary function in the execution of the public policies.

Thereby, a country who has the Brazilian inequalities and social unfairness cannot deprive or disregard the action of a public financial system who, acting synergistically, can be one great ally and effective instrument in the continuous search of progress.

4. SYNERGY AMONG FEDERALLY-OWNED BANKS

If on one hand public financial institutions have suffered the effects of the fall of inflation and the shrinkage of Brazilian financial system, on the other hand their performance were worsened by many particularities of their actuation.

Almost all these banks acts either with individuals or institutions, most in the banking retail. This fact leads to one situation that could be qualified as "autophagic competition" in which they faces the threat of privatization struggling each other in order to reserve a strategic and/or privileged place regarding the governments.

The entropy of that system can be exemplified by the overlap of activities and by the existence of branches of different state-owned banks in same places, fighting one another for the same customers.

In the case of BNDES, the situation is still more unusual: in many cases, he acts basically as an intermediary between banks (including state-owned), capturing public (or originating public) resources, transferring them - with the most of the risks - to the financial agents and charging them for it. Thereby, the financial cost of these kinds of loans is needlessly increased, what is not advisable regarding the Brazilian lack of financial resources for investments.

Thereupon, a great part of these problems could be solved through the redesign of the public banks' chains, in order to eliminate conflictive points. Beside this, governments could take advantage of the "expertise" of each bank and, still, create a unique structure that could maximize the efficiency of the utilization of the available resources, regarding a global vision.

5. ALTERNATIVES FOR THE FEDERALLY-OWNED BANKS

1. Maintenance of the Current Institutional Configuration

The first reflection concerning which one would be the most suitable configuration for federally-owned banks links with the maintenance of the current one and the enforcement of the strict execution of the functions undertaken for to each bank. Under these circumstances, the best solution is the one proposed by COMIF:

- **BANCO DO BRASIL**: main financial agent of the National Treasure and head of the federal financial conglomerate, destined to the credit in general, with emphasis in the rural credit and in the fostering of the foreign trade;

- CAIXA ECONÔMICA FEDERAL: credit to the housing sector, sanitation, urban development, management of public funds and programs - with segregated administration, financial flows, accounting budget and still execution of Governmental special activities, such as lotteries, unemployment insurance and pledges;
- BANCO DO NORDESTE DO BRASIL: fomenting activity in the Northeastern Region, concentrating in the management of the constitutional funds destined to the area;
- BANCO DA AMAZÔNIA: fomenting activity in the Northern Region, concentrating in the management of the constitutional funds destined to the area;
- BANCO NACIONAL DE DESENVOLVIMENTO ECONÔMICO E SOCIAL (BNDES): fomenting activity of wide character, with emphasis on the Brazilian productive and infrastructure sector.

If it were possible to limit the roles played by each institution to the mentioned above, they would be minimized several "overlapping areas". However, it wouldn't solve one of the main conflicts today observed, which is, the overlap of branches and the "autophagic competition" among them aiming to maximize the attainment of resources for to the accomplishment of its responsibilities.

1. Merger of the Institutions

A second option would be simply to merge those institutions, so that they would act in a wide variety of public policies. Contrary to the previous alternative, such a program would rationalize the attendance logistics, optimizing costs.

However, the multiplicity of functions, besides the lack of financial resources to fulfill them appropriately, could cause difficulties regarding the prioritization of the activities and the distribution of the resources. Thus, this alternative could just transfer to the company's internal environment the current overlapping areas.

More than this, that configuration obstruct the transparency of decisions and information, since it hinders the mensuration of costs and, thus, the profitability of each activity. It is important to say that such difficulties could be increased, depending on how would be this institution from the juridical standpoint.

By the way, in this point it is worth reflecting on which would be the profile of a public bank. Two alternatives seem closer: Corporation or Public enterprise. At first glance, the profile of public enterprise would be more attractive since, for its own non-profitable nature, it would favor social stamp operations.

However, in the current world the transparency is more than ever crucial in the fulfillment of public policies. The profile of public enterprise doesn't favor this demand, once the instruments of control on the part of the society remains bounded to the same public sector that run the enterprise.

If the chosen option were the corporation, there would be no so much controls as observed in a public enterprise. On the other hand, that institution could be less submitted to inappropriate political interference that would harm operational efficiency.

The corporation profile would increase alternatives of funding aiming the execution of governmental policies, once it could give better conditions for dealing with multinational organisms and financial institutions, besides their own private agents. A proof of this is in the image that Banco do Brasil enjoys in several foreign countries, in many cases much better than the one of Brazil, as a whole.

Therefore, even if being about the strict execution of inherent functions to the State, the corporation alternative seems more suitable than the one of public enterprise, from the standpoint of the efficiency in the reception and in the application of resources to attend to government goals.

2. Creation of a Holding Company and Specialization by Activities

The third alternative is considered the most appropriate once it joins the advantages of the first and the second ones, besides to propose a modern solution of organizational engineering, in line with the contemporary world. This solution also allows to end up with the most remarkable characteristic and, at the same time the main source of inefficiencies in the federally owned banks, that means the overlapping of functions and branches.

The idea is that, considered the multiplicity of federal financial institutions and the overlap of actions, those companies would have its structures submitted to a merger process, being rearranged according with its roles, the most already defined by COMIF.

Starting from there, it should be analyzed which would be the best institutional configuration of these federally owned institutions. If considered the current Brazilian fiscal crisis it is supposed to be the most flexible in order to allow a variety of partnerships, strategic alliances and also the optimization of costs and revenues.

Furthermore, because this is a controversial matter either from the juridical or the political standpoint, it would be opportune to maintain as well as possible some existing features, including their names. Therefore the most suitable configuration is the one shown in the following figure, where all the companies would be corporations.

The "financial conglomerate" would be a corporation with shares traded in the stock markets. Its main functions would be to unify the attendance – contributing to the synergy of the companies and the optimization of resources within them – and to act in the behalf of them as the operational arm of the group, in the most of the cases.

It would act in market "basis" and with high "scale", what would guarantee better ratings in the finance and capital markets with regard to the reception of the resources to be used for accomplish the group's goals.

Although this company wouldn't be the supplier of subsidized resources, it would be useful in the credit operations in which the main problem is not the financing rate but the lack of available resources, as in the case of much foreign trade operation. Nevertheless, considered its public-owned characteristics, it wouldn't necessarily look for the profit maximization, looking only for a "fair" profit and hence offering better conditions of periods and rates.

The other companies of the group would act as managers of the resources driven to them through the holding company. This, for its time, would apply such financial resources according to pre-established government priorities, through previous budgetary endowments and attainments from the financial conglomerate. They would be:

- Bank of fomentation to the foreign trade;
- Bank of rural credit;
- Bank of credit to the housing sector, sanitation and urban development
- Bank of fomentation to the other economic productive sectors and infrastructure;

These companies would be owned by the Government (50% plus 1 of the voting capital) and any other institutions that could be interested in this partnership, as Pension Funds, Non-Governmental Organizations, Multilateral Institutions (World Bank, Inter-American Development Bank etc.), besides other economic agents. Hence, they would be administrated according the share of capital owned by each institution, what would allow the democratization and transparency in the decisions and in the supervision.

They should be, still, free from most of the limitations today imposed because of their state-owned nature as a form of decrease their operational costs and turn them more agile. In the same way, all the institutions would be submitted to an "management agreement", that would clearly define goals and resources to fulfill them.

1. COSTS OF THE ALTERNATIVE OF CREATING A HOLDING COMPANY, AS SEEN IN THE 10.3 ITEM

Every change involves costs and benefits to be balanced. Thus, besides the benefits already mentioned there are also costs. Although this proposal of reconfiguration do not involve obstacles that cannot be overcome, they are real and difficult to solve. Nevertheless, considering the Brazilian fiscal limitations and the huge social debt, its crucial to begin it as soon as possible in order to not waste public resources financing disputes between institutions that, after all, belongs to the same owner (the Brazilian society).

1. Political Obstacles

We believe that the main obstacle to be overcome is would take place in the political arena. On the other hand, the current moment is suitable for the inclusion of this proposal in one govern program regarding the next elections, since the current government remains very popular, enjoying the success of the "Plano Real". Besides this, the most important existing official financial institutions will remain with their mission and social objectives unchanged.

2. Reduction of The Number of Workers

The most remarkable consequence of this proposal is the reduction of the number of employees, since this configuration rationalizes the structure of the official credit system. Regarding this, there are two main streams to solve this problem:

The most fast, cheap and effective way is the very dismissal of the unneeded workers, obviously after a human resources reallocation process that allow to place the employees according to their expertise and the priorities of the group, even in areas lacking bank services. This option may be neither politically nor socially opportune, considering the current perspectives of low GDP growth and increasing unemployment rate.

The second alternative would be to take advantage of the high average of years worked in every company by each employee and wait the retirement of each worker.

It seems that the most appropriate option could be to increase advantages offered in the existing dismissal programs or to launch additional ones, besides fostering those who have enough time to retire.

3. Other

Besides the problems identified there must be several other, operational or politic ones. The most noticeable seems to be adaptation of each information system to the new environment, the concentration of power in one institution (the holding company), the new equilibrium to be reached when new partnerships are made and the submission to the "Bidding Laws".

<i>ADVANTAGES</i>	<i>PROBLEMS</i>
<ul style="list-style-type: none"> • Increase of Competitiveness and Productivity 	<ul style="list-style-type: none"> • Dismissal of Employees Unneeded
<ul style="list-style-type: none"> • Rationalization of Operations 	<ul style="list-style-type: none"> • Politic Resistance
<ul style="list-style-type: none"> • Economies of Scale 	<ul style="list-style-type: none"> • Loss of Control by Politics
<ul style="list-style-type: none"> • Increase of Partnership Among Public and Private Agents 	<ul style="list-style-type: none"> • Concentration of Power in one Institution

Increase of Flexibility among Public and Private Agents	Concentration of Power in the Institution
<ul style="list-style-type: none"> • More Flexibility 	<ul style="list-style-type: none"> • Resistance in the Private Banking System
<ul style="list-style-type: none"> • Better Coordination of Goals and Actions 	<ul style="list-style-type: none"> • Employees' Resistance
<ul style="list-style-type: none"> • Planning in Advance and Clear Definition of Resources 	<ul style="list-style-type: none"> • Shrinkage of Structures
	<ul style="list-style-type: none"> • End of submission to the "Bidding Law"

1. CONCLUSION:

Brazil is facing a time of deep and important changes. Several paradigms are being broken and adjustments have become crucial for reaching one, at the same time modern and fair world.

In Parallel, new forms of seeing the State appear. Facts as the aging of the populations and the growing access to the information about the developed countries societies' standards of life have been increasing demands of the populations worldwide, chiefly in the developing countries.

At the same time, governments are being stressed by fiscal limitations that hinder the fulfillment of their functions. In this environment, it becomes crucial the establishment of partnerships between public and private agents in order to share responsibilities which, after all, are everyone's responsibilities.

In this scenery, it is not the origin or the capital owner the most important: what really cares is to know if it is being addressed, one way or another, to the progress, either economic or social, considering the efficiency in the allocation of the resources throughout the country.

The current Brazilian moment doesn't allow to give in the potential of public financial institutions, even for not to burden private institutions, avoiding a more regulatory behavior in order to minimize problems in which is crucial a short term Government action.

The goal of that proposal is look for an alternative that can join the best features of the private and public enterprises, seeking optimize efforts for the development and the fulfillment of the social debt left by centuries of distortions and mismanagement, that begin to be corrected, whatever the origin of the problem or the resources (public, private or both). And, *"if the ends don't justify the means, what does"?*

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Appendix

BRAZILIAN FEDERAL CONSTITUTION – Chapter IV

THE NATIONAL FINANCIAL SYSTEM

Art. 192 - the national financial system, structured in way to promote the balanced development of the Country and to serve to the interests of the collective, will be regulated in complementary law, that it will dispose, besides, on:

I - the authorization for the operation of the financial institutions, assured to the banking official and private institutions access to all the instruments of the bank financial market, being hindered to those institutions the participation in activities not foreseen in the authorization which treats this item;

II - authorization and operation of the insurance establishments, social welfare and capitalization, as well as of the supervising official organ and of the reinsurance official organ;

III - the conditions for the participation of the foreign capital in the institutions referred by the previous items, aiming, especially:

a) The national interests;

b) The international agreements;

IV - the organization, the operation and the attributions of the Central Bank and other public and private financial institutions;

V - the requirements for the designation of the board of the central bank and other financial institutions, as well as its impediments after the exercise of the position;

VI - the creation of a fund or insurance, with the objective of protecting the popular economy, guaranteeing credits, applications and deposits until certain value, prohibited the participation of resources of the Union;

VII - the restrictive approaches of the transfer of saving of areas with inferior income to the national average for another of larger development;

VIII - the operation of the credit cooperatives and the requirements so that they can have operation conditions and own of the financial institutions structuring.

§ 1st - The authorization which refers the items I and II it will be unnegotiable and untransferable, allowed the transmission of the control of the titular legal entity, and granted without obligation, in the form of the law of the national financial system, to institutions whose directors have technical capacity and unblemished reputation, and that prove economic capacity compatible to the enterprise.

§ 2nd - The financial resources concerning regional programs and projects by Union responsibility will be deposited in its regional credit institutions by them managed.

§ 3rd - The real interest rates, included commissions and any other remuneration directly or indirectly referred to the credit concession, cannot be higher than twelve percent a year; the collection above this limit will be considered as crime of usury, punished, in all of its modalities, in the terms determined by the law.