Brazilian State Owned Enterprises: 
A Corruption Analysis

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INTRODUCTION

The recent history of Brazil was highlighted by several corruption schemes that were identified by its law enforcement agencies. Actions developed by the Federal Policy, Office of The Comptroller General, and Public Prosecutors made the headlines of newspapers across the country, while cases of embezzlement, illicit enrichment, procurement fraud, among others, were found and brought to the knowledge of society.

In all of these situations, the corruption necessarily involved the participation of public officers. Whenever there is a sector of economics that is regulated by the government or there are private interests that depend of the action of the State to be fulfilled, there is an opportunity for a public officer to be corrupted.

Even though some studies suggest that corruption can promote positive aspects to economic development, as it will be presented in the specific topic later ahead, the majority of the researchers argue that corruption encourages secrecy, distortionary regulation, and bribery which, in turn, reduce economic efficiency and growth. That also seems to be the population perception and concernment. A survey conducted by the Latinobarometer\(^1\) has pointed that 58.3% of the Brazilian people interviewed answered that the reduction of corruption is the principal aspect for a better democracy. The same survey also indicates that population classifies corruption as being the fifth worst problem in the country.

Many of the biggest cases of corruption that took place in Brazil in the last years happened within state owned enterprises (SOEs). SOEs represent the most direct way for a government to interfere in the economy, by acting as a market agent. SOEs are directed by public officials who, in this condition, are in charge of huge resources and submitted to regulation that can be more lenient than the one that is imposed to the rest of Public Administration.

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1 Latinobarómetro - Round 2011.
Trying to understand this phenomenon, this research aims to provide a comprehensive study of the main corruption cases that occurred in Brazilian state owned enterprises, analyze if SOEs are more susceptible to corruption and establish some possible solutions by discussing new ways of government intervention that can avoid new corruptions cases.

This paper is organized in six different chapters. The first one presents a short overview of the different concepts used to explain the meaning of the word corruption. This brief study about what scholars and the international community understand about the corruption phenomenon is important to explain how it is related to the role of government in a society. The second chapter discusses how corruption affects economic development. The main objective is to present the two different approaches that analyze the impact of corruption on markets and economic growth, demonstrating how important it is to study why corruption occurs and ways to prevent it. In the third chapter, the origins of State Capitalism is presented in an effort to try to find the reasons that lead Brazil to decide to have so many state owned enterprises (SOEs). In addition, the chapter also includes an overview of the main legal framework aspects of SOEs, distinguishing them from the other kinds of public entities.

After the overview presented in the chapters 1 through 3, chapters 4 through 6 will more specifically analyze with corruption cases. Chapter four presents Robert Klitgaard’s corruption analysis framework and offers it as a way of understanding why corruption seems to occur in SOEs. In this sense, four different characteristics of SOEs are studied as a way to apply Klitgaard’s analysis framework: procurement regulation, workforce legislation, budgetary process, and transparency regulation. Next, chapter five presents three different corruption cases that took place in Brazilian SOEs in an effort to apply the analysis framework presented in the previous chapter. Finally, chapter six presents the existence a world trend towards the change in the role of SOEs. In this sense, it will be discussed if this
change could reduce of corruption. In the conclusion, the paper summarizes the main issues previously discussed and provides perspectives of new studies.
1. WHAT IS CORRUPTION

The word corruption, even though is broadly used by the society on a daily basis, it is not a uniform concept that is applied in the same sense by scholars and the international community. Zani Brel suggests that scholars have been dealing with corruption studies with different points of view. These points of view can be divided in four different categories: (i) the ones focused on market and economic aspects, (ii) the public interest point of view, (iii) the legal framework approach, and (iv) the ones concerned with public opinion.

The studies focused on market aspects see humans as economic agents who are always trying to maximize their profits. Using this paradigm, corruption between public officials and private agents can be easily explained. As an important actor in the market having the power to regulate various subjects, the State can provide benefits or impose barriers for private agents. Then, since the private agent always pursues more profit, corruption can be seen as a more efficient way to increase his revenue. On the other hand, the public agent, while invested with the power of the State, can see being corrupt as a possibility to acquire an increase in his income.

However, this theory does not explain several important aspects to better understand the corruption phenomenon. First, corruption deals with important matters related to ethics aspects that can explain in which extension a person is willing or not to commit an act of corruption. Furthermore, this approach does not explain how the agents can be constrained by the fear of suffering sanctions in response to their acts.

The second theory sees corruption as the act that harms a public interest. In this sense, the explanation is based on moral and ethical aspects only. An act will be considered a corrupt one when it violates a public interest on behalf of a private one. This way, all the community is harmed in the benefit of just one person or a few people.
Even though, this perspective is successful in dealing with moral issues relating to corruption, it leaves space for an excessively broad use of the term corruption. For instance, there is very difficult to establish when an act is too serious to be considered as a corruption act. For example, if a public agent takes a pen form his government office he is for sure misappropriating a public object that belongs to the State, but can that be considered an act of corruption? Because of this lack of parameter, the public interest perspective can lead to an imprecise concept of corruption.

Furthermore, once the concept is based on ethical and moral perceptions, there will be greatly difficult to establish a concept that can be applied globally. Moral standards can vary depending on the context in which people are living. Different societies usually value morals and ethics on a different basis, which makes it difficult to assemble a unique concept that can take into account all the different perceptions of the issue.

The third theory establishes that the law should say which are the corrupt acts. In other words, corruption is the act reproved by laws passed by congress, which represent the community. This criterion, even though it is essential for the state to be able to impose sanctions, is restricted by the limitation inherent to the text that describes the illegal act. As a general rule, it is extremely difficult to admit that a single rule or a set of them will be able to describe all the conceptions that the term corruption is applied by the society.

About this approach, it is interesting to point out that the international community has pursued a path that tries to overcome this obstacle. Once it seems impossible to adopt one single concept of what is corruption, international treaties have chosen to create a range of acts that can be considered corrupt and, as a consequence, should be repressed by the signatory countries.

Just to mention some examples, Brazil has taken part on the following international treaties that focus on the fight against corruption: Inter-American Convention against Corruption (Caracas/1996, promulgated by the Decree 4.410/2002) and United
Nations Convention against Corruption (Mérida/2003, promulgated by the Decree 5.687/2006). These conventions do not establish a single definition of corruption, but they set a range of acts that should be criminalized by the States parties.

At last, the fourth different approach tries to find out what is corruption regarding the public opinion. Through different surveys and polls, the scholars try to find out a common ground over the different people that are interviewed. As it would be expected, most of the studies have shown that people seem to have different perception about what corruption is. Nonetheless, Peters and Welch³, have managed to describe at least a set of components that people general take in account when trying to decide if an act can or can not be considered corrupt:

a. the type of position and the role of the public official involved;

b. relation between the donor and the public official;

c. the kind of favor rendered by the public official;

d. the amount of the payoff, how it benefits the donor, and if it is related to a campaign.

By this measure, it is possible to say that society have the tendency to evaluate the seriousness of a corruption case according to the importance of the public official involved, the amount of money that was given as a bribery, and the kind of favor that was conceded.

It seems evident that, even though all the perspectives help in a different way to better our comprehension of corruption, there does not seem to be an existing theoretical solution that establishes a satisfactory and exhaustive concept of the term corruption. But the impossibility to define a single concept does not configure an obstacle on the pursuit of fighting corruption. The different views and attempts to explain corruption only point out how important the subject is for society.

Corruption, in essence, is a lack of a collective sense. If the individual does not feel part of a group, he can acts without the feeling of guiltiness and the perception that practicing an act of corruption he is harming the whole community. That is why the concept of corruption has changed through the years. When the people where ruled by a king it was harder to have the same sense of what corruption is as we have today. There was not the idea of a common good, the State was the king and, in that way, whenever taking something from the State you were robbing the king and not the community.

As societies develop and democracies emerge, people start having the perception that everything that the State owned belonged also to everybody. And as this concept becomes more robust, the society tends to consider every act that attempts against the collective as an act of corruption. Samuel Huntington has shown the same perception when studying the modernization of societies. In his words, “Corruption in a modernizing society is thus in part no so much the result of deviance of behavior from accepted norms as it is the deviance of norms from the established patterns of behavior”\(^4\). Huntington establishes that the behavioral pattern of a society is not always represented in written laws, but much more on the moral standards, which are volatile over the years.

Other important conclusions can be reached by the overview of the different perspectives of corruption. In all approaches, there is an element that points out as an important aspect of corruption: the involvement of a public official. It is also possible for two private agents to engage in corrupt acts, such as taking money from the government, without necessarily involving a public official. However, it seems that the society is more worried about the acts of public officials, whose corruption is therefore more subjected to the disapproval of public opinion. Taking in the consideration society’s focus on acts of public

\(^4\) Huntington, 1968.
officials, for the purpose of this paper will use Klitgaard’s\textsuperscript{5} concept of corruption, meaning the misuse of office for personal gain.

\textsuperscript{5} Klitgaard, 2000.
2. CORRUPTION AND ECONOMIC DEVELOPMENT

Although society in general clearly seems to be against the assumption that corruption could in someway benefit economy, it is possible to find some scholars that have defended the idea that in specific situations, corruption could help diminish the slowness of the government and, therefore, promote positive aspects to the economy. The latter is called the “grease on the wheels” hypothesis⁶.

Even though research has not produced any study defending that hypothesis in the past 10 years, it is interesting to go through some of those studies to analyze the aspects that were taken in consideration and to compare the characteristics on which they focused and those on which recent studies focused.

One thing that is relevant, is that the defenders of the “grease on the wheels” hypothesis are not worried with moral aspects related to the corruption. Their point of view is based only on an economic and efficiency point of view. By that aspect, those scholars seem to be worried about how business can be affected by inefficiency when state regulation establishes that a private person can not operate in the market without government permission or its intervention. When that is the situation, every bureaucrat demand is seen as a cost to the businessman. Thereby, any attempt to reduce that costs is claimed to be legitimate in the pursuit of efficiency, profit and, ultimately, economic growth.

Brooks et. al.⁷ summarize the “grease on the wheels” arguments:

a. bribes might offer bureaucrats an incentive to quickly process the establishment of new firms in an otherwise sluggish administration;⁸

b. corruption could efficiently reduce time spent queuing for ‘services’;⁹

c. corruption has the potential to amend a bureaucracy by improving the quality of its civil servants once it can provide an increase in their wages;¹⁰

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⁶ Brooks, et. al., 2013.
⁷ Brooks, et. al., 2013.
d. corruption replicates the outcome of a competitive auction aimed at assigning a state procurement contract because the ranking of bribes replicates the ranking of firms by efficiency.\textsuperscript{11}

As it’s possible to see, the “grease on the wheels” hypothesis has the presumption that corruption could lead to an improvement on bureaucracy efficiency on government administrations that have fragile institutional frameworks and are not capable to perform their duties in the promptness and agility required by the market. Nonetheless, those arguments cannot be supported nowadays.

The idea that corruption is harmful for all the community and especially for economic development is broadly accepted, even on States that the public administration is yet not fully institutionalized. On developing countries, corruption is seen as an obstacle to the consolidation of democracies in the way that erodes the public confidence on the government and lead to a vicious circle. Once corruption is seen as a widespread practice on the government, the community does not feel obliged to respect state regulations, leading to more illegal acts that, eventually, ruin democracy and the rule of law.

The counter-theory of the “grease on the wheels” hypothesis is called “sand on the wheels”. In this perspective, even in just an economic point of view, corruption is seen as a great impediment of society growth and development. Those are the arguments that support the “sand on the wheels” hypothesis as pointed out by Brooks et. al.:

a. corrupt officials have an incentive to create distortions in the economy to preserve their illegal source of income;\textsuperscript{12}

b. corrupt civil servants may cause delays in order to raise their bribe;\textsuperscript{13}

c. in procurement bids, the highest bribe may simply be paid by the one that is most willing to compromise on the quality of the goods they will produce;\textsuperscript{14}

\textsuperscript{10} Bayley, 1966. 
\textsuperscript{11} Beck e Maher, 1986. 
\textsuperscript{12} Kurer, 1993. 
\textsuperscript{13} Myrdal, 2004.
d. corruption transactions are operated in an unregulated market, then they are subjected to more uncertainty than official transational, leading to inefficient decisions on an economic point of view.\textsuperscript{15}

Méon and Sekkat\textsuperscript{16} went further in their studies gathering empirical data regarding whether corruption has an harmful impact in economic development or, in opposite, if it can be a way to private enterprises to reach their goals overcoming the inefficiency of public institutes. According to their analysis, there is consistent evidence that corruption is extremely bad for economic growth, specially in countries where governance is poor. Using a regression model, those scholars compared two different corruption indexes (the Corruption Perception Index, produced by International Transparency and the one provided by the World Bank) with governance data (such as accountability, political violence, government effectiveness and regulatory burden) and economic data (such as GDP, per capita income and ratio of investment over GDP). The result is evidence that corruption hampers economic development, even when the amount of investment is not reduced. In other words, even when there is an increase on investment, it is possible to verify a decrease on GDP per capita when there is a high index of corruption.

The explanation of such evidence can be linked to the inefficient decision-making process caused by corruption. Corruption may drives public investment to sectors that allow greatest extraction of bribes in place the ones that are more important to the population, and also can leads to distortion on the allocation of entrepreneurial talent and give an incentive to allocate agent’s energy to rent seeking instead of other productive activities.

The results of Meon and Sekkat are more evident where there is lack of good governance and weak rule of law, therefor, implying that reducing corruption is even more important to developing countries that do not have a government framework well established.

\textsuperscript{14} Rose-Ackerman, 1997.
\textsuperscript{15} Bardhan, 1997.
\textsuperscript{16} Meon and Sekkat, 2005.
The “sand on the wheels” hypothesis has also been incorporated by international organizations, such as the Organization of Economic Co-Operation and Development (OECD). Its Convention on Combating Bribery of Foreign Public Officials in International Business Transactions has demanded its member countries to enforce law against corruption acts committed by enterprises. That initiative represents an important statement that corruption is a great obstacle to free markets and economic development.
Once establishing the harmful consequences of corruption, it is important to focus on the factors that can lead to it. Even though corruption is a universal problem, it seems that different countries and sectors are particularly susceptible to it. As seen in the previous topic, the lack of strong institutionalized governments and good regulatory frameworks can either be the cause or the effect of corruption. In this sense, it seems appropriate to discuss if corruption is also related to the size of the government, being more likely to occur when the State tries to regulate more than it should.

In the specific topic regarding the definition of corruption, we mentioned Huntington’s ideas. For him, the concept of corruption must consider the morality of each society. To reach that conclusion, Huntington claims that corruption, as a concept, only appears with the modernization of a given society, when it is possible for the population to distinguish the public role from the private interest. Before that, during the feudalist period, it seemed difficult to the population to claim whether or not the actions of a king, for instance, were corrupted. Even though they could complain about the fairness of his actions, it is unlikely to say that the king’s appointment of his cousin to been in charge of the royal expenditures was an act of corruption or nepotism.

According to Huntington’s line of reasoning, as the society modernizes and the differences of the public role and private interests become more evident, people start to identify corruption as occurring whenever a private interest undermines what should be the role of the government. Therefore, the more the government claims to be its own function, and, consequently, regulates a wide range of private interests, the more room there will be for corruption to occur. In his words:

“Laws affecting trade, customs, taxes plus those regulating popular and profitable activities such as gambling, prostitution, and liquor, consequently become major incentives to corruption. Hence in a society where corruption is widespread the passage of strict laws against corruption serves only to multiply the opportunities for corruption.”
Of course, nowadays, it will be hard to find a lot of people who will complain about state regulation on topics that, left without control, might generate severe consequences to public health or safety. Examples of this might include the use of drugs or sexual exploitation. But, for sure, there is a lot of interest regarding the discussion about how deep government regulation should be. Because of this, Huntington’s point of view remains relevant today.

Under this perspective, this paper wants to discuss the reasons why a State chooses to both regulate and act directly in the market by owning enterprises. That is what is called “State capitalism,” or the instances when an economic activity is undertaken by the State, and that State chooses to manage and organize the means of production.

3.1. Origins of the State Capitalism in Brazil

Lazzarini and Musacchio\textsuperscript{17} say that “State capitalism” peaked in the middle of the 1970s when European governments nationalized firms in large numbers and governments in developing countries either nationalized firms or created (and then owned) tens or hundreds of other ones. The size of this movement can be exemplified by the output to GDP that state-owned enterprises reached at the time (10 percent in mixed economies and close to 16 percent in developing countries).

Through the next two to three decades, many countries tried to improve the efficiency of those public companies, establishing profit goals and providing high level training to their executives. Nevertheless, during the end of the 80s and beginning of the 90s, state owned enterprises all around the world faced severe losses, reaching 4 percent of the GDP in developing countries according to World Bank data. Due to this situation, a large number of public enterprises were privatized.

\textsuperscript{17} Musacchio and Lazzarini, 2014.
According to scholars, there are at least four different explanations of why governments chose to create or nationalize firms. The first one is based on a perspective related to the industrial development of the country, by overcoming market failures that lead to low investments. Especially in less developed countries, the main arguments are that investments are constrained, there are coordination problems in the production chain, and the cost of developing new technologies is extremely high. In those cases, the government could act through SOEs, which borrow money directly from the State, coordinate production problems easily with other SOEs that are part of the production chain, and promote research regarding new technologies financed by tax money. In other words, the government could act in pursuit of industrial developments without the natural constraints of private investment.

The second explanation sees SOEs as governmental instruments to achieve social objectives. In that sense, once SOEs are not profit-driven, they can locate plants in uneconomic areas, generate employment, set prices below market, and focus on projects that may deliver results only in the long run. The last factor might lose interest among private investors.

The industrial policy and social views, presented above, are optimistic explanations and focus on the merit of SOEs. The third perspective is more pessimistic and is concerned with the political aspects related to SOEs. In this view, SOEs are seen extremely vulnerable to political objectives and thus are more subject to inefficient performance, considering that their projects will be guided by the benefit of political interests that are not necessarily tied with social benefits. Lacking the pressure of private investors, SOEs can also fail in management, considering that cutting costs in crises periods can be a unpopular measure and ultimately lead to political losses.

The fourth explanation argues that state capitalism emerges, changes itself to other forms of state intervention, or chooses privatization due to the country’s institutional level and its historical process. This perspective is known as the path dependency view, under
which governments take into consideration local ideology and attitudes toward public or private ownership. If a society tends to expect and rely more on the government to be the main provider of welfare, the existence of SOEs will be more commonplace, and a process of privatization will have to be driven more carefully or perhaps even partially, with the State still having some kind of minority participation in recently privatized companies. Conversely, in a more liberal society, people tend to expect that markets will lead to more optimum solutions, therefore governments will be less inclined to choose SOEs as an instrument of state intervention.

Regarding Brazil, the biggest movement toward more intense participation of the State in the economy through state companies date back even earlier than the global peak of state capitalism. During Vargas (1930-45) first government, and because of a strong import substitution in industrialization, several state owned enterprises were created. Examples of this measure are the Vale do Rio Doce Company, a mining enterprise (1942); the São Francisco Hydroelectricity Power Company (1945); and during his second government, Petrobras (1953), an oil company. But even then, other important state owned companies already existed for many years, such as the Bank of Brasil, Caixa Econômica Federal (both public banks), and Correios (postal service).

Before Vargas administration, it is possible to identify several actions of the State towards the development of an economy that matches some arguments of the industrial policy view. At first, the presence of the State was limited to help some private companies in achieving more attractive profits to keep them in business. That was the case, for example, when the subsidies were given to private shipping and railway companies during the last decades of the XIX century and early XX. In several cases, the State ultimately took control of several firms after bailing them out. That was the case of the Lloyd Brasileiro, that was the result of the merging of four shipping lines that had been receiving subsidies and protected from foreign competition, after falling under government control.
The industrial policy view is also helpful in explaining the large number of SOEs that were created during the Vargas Administration and enhanced by the military dictatorship (1964-1985). During that period, the government was seen as the main driving force towards industrial development. Nonetheless, political and path-dependency also are extremely important in understanding that period. As non-democratic and centralized governments, State intervention was also easier to take place without the need of discussing with the society and congress. The political sustainability of the regimes was also based on the perception that the State was in control of all aspects of the decision and would drive economic development successfully.

But, during the 90s, several public companies were privatized by the Collor and Franco administrations and, with more intensity, by the Cardoso government. The process of privatization of the Brazilian SOEs primarily started with the economic crisis of the 80s. According to Musachio and Lazzarini there were at least three motivations behind Brazil’s privatization program, described below.

The first motivation has to do with control of government expenditures. In the early 90s, most of the Brazilian SOEs were technically bankrupted and required constant aid from the Treasury, syphoning away some of the scarce resources from the government budget.

The second motivation at the time was that the Brazilian government had to pay high interest rates on its debt, which increased the opportunity cost of holding equity in SOEs. From 1988 to 1994, the average dividend for all federal SOEs was around 0.4 percent, while the government had to make debt payments that could range from 20 percent per year to 1,000 percent for short-term debt. Thus, the returns from SOEs were low if compared to the high opportunity cost of the government equity.

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18 As Musachio and Lazzarini (2014) point out the 1979-1983 crisis was the worst recession in Brazil’s modern history.
The third and last motivation was privatization, seen as a way to increase efficiency in the economy, by heightening the productivity of privatized SOEs and liberalizing the prices that were then controlled by the State.

Despite the intense process of privatization, the Brazilian government maintains a fairly number of SOEs under its control in current day. According to data provided by the Brazilian Ministry of Planning\(^\text{19}\), Brazil has 47 firms under the direct control of the federal government, with assets worth $625 billion. Five of these 47 SOEs are holdings that control 68 subsidiaries, which increase total assets to $756,8 billion as controlled by Brazilian government through public enterprises. Just to give an idea of the importance of Brazilian SOEs, Brazil Gross Domestic Product for the year 2013 was $2,3 trillion.

3.2 Legal framework of Brazilian SOEs

Since this article focuses on the Brazilian experience, it is important to establish the way its Public Administration is structured and what is the legal framework of the public companies are. For the purpose of this paper, only the Federal Executive Branch will be studied, due to both its national importance and status of a role model to the State and Local levels. The Brazilian legal system determines that the Public Administration should be organized on two different levels: the direct and the indirect administration entities.

The direct administration is composed by the Chief of the Executive (the President) and its Ministries. Under the orders of the President, each Ministry is responsible for designing the public polices related to the matters within its competencies. The public policies can be executed by the Ministry itself, by the transfer of money to the State or Local level, or by other entities of the indirect administration.

Agencies, departments, public foundations, and state owned enterprises compose the indirect administration. Each agency and department is responsible for a different public activity, such as market endeavors, health care, sanitary and environmental regulations, and

\(^{19}\) Gathered by Musachio and Lazzarini (2014).
supervision. They are also in charge of specific public services, like the construction and care of roads, law enforcement, and concessions of social benefits. The public foundations, in most cases, are responsible for the management of public universities and hospitals. The SOEs are responsible for the provision of several public services and the exploration of some economic activity, whenever it is in the interest of the state.

All of the indirect entities are on the same level and each one is directly under the supervision of a Ministry or, in few cases, of the President himself. Therefore as a general rule, the direct administration is responsible for the planning and designing of public policies, while the indirect administration is responsible for its implementation. In order to make these roles clearer, some examples will be described.

The Ministry of Social Security is responsible for some welfare policies. Under its supervision, there are three indirect entities. One of them is the National Social Security Institute, which is responsible for providing social benefits, such as pensions and health licenses, under the guidelines of the Ministry of Social Security.

A good example of how a Ministry relates to its state owned enterprises is the Ministry of Mines and Energies, which is in charge of national energy policy. To implement this policy, the Ministry has three agencies that are responsible for regulating the oil, energy and mine markets. Also, the same Ministry has two big public companies that are responsible for providing most of the electricity of Brazil (Eletrobras) and exploiting oil (Petrobras). By this example, it is evident that the Brazilian state has chosen to establish different kinds of entities depending on the nature of the activity that needs to be performed.

Regarding state owned enterprises, the important aspect to draw attention to is the fact that it can either execute public services or exploit economic activities. However, in Brazil, public service can also be provided by a public department or even by a private enterprise, under a special concession and supervised by a public entity. Also, according to the Brazilian Constitution, the State should generally not exploit an economic activity.
Nevertheless, the same Constitution makes two exceptions to this rule. Article 173 points that the State should only engage in an economic activity when it is necessary for the national security or on behalf of a “relevant concern of the community.”

Having that information, someone could ask what the difference is between a public service and an economic activity that is important to the community. Is the distribution of electricity a public service or an economic activity? What about postal service? Regardless of the way the answer is chosen, the reality is that the Brazilian state, as we have already seen chooses to directly exercise those functions instead of leaving it to private markets or even hiring a private enterprise to do the job under a concession model.

Another reality is that Brazilian SOEs have been involved in several corruption schemes over the last few years. What is most concerning is if this kind of state intervention presents fragility on the governance aspect that can lead to more illegal actions taking place. The next topic to be discussed will be the Brazilian SOEs’ characteristics through the lens of corruption control.
4. BRAZILIAN SOEs AND CORRUPTION ANALYSIS

Klitgaard suggests that corruption is likely to occur whenever there is a monopoly power with great discretion and low accountability. In this case, monopoly power is the capability of someone to decide over a good, service, or how much one person receives. Monopoly power can be especially dangerous whenever it is exercised without limits, when there are no ways others can see what the decision is, and on what basis it was made.

In an effort to try to analyze the corruption cases involving Brazilian SOEs, this paper will present its main characteristics under Klitgaard’s framework. But first a comparison between the laws that regulate SOEs are especially important in understanding the differences between them, other agencies of the government, and private enterprises.

It is important to point out that Brazilian regulations related to its public administration are extremely extensive and detailed, and contains several exceptions that can be applied to some entities. For this reason, the aspects that are going to be studied here are focused on the main rules that may have some relation towards corruption acts and that is why some other topics will be left outside.

The Brazilian Constitution establishes that the public administration is subject to a special legal framework, different from the one that is applied to private enterprises. According to its Article 37, the Constitution says that the public administration should act in observance of five principles: legality, impersonality, morality, publicity, and efficiency. That means that public administration should only act when there is a specific legal authorization, on behalf of the whole community, observing the moral standards, letting people know its decisions, and choosing always the ways that it is less expensive and faster.

In a different direction, private enterprises are free to act in whenever way it should want, as long it is not against the law. It only has to look out for the interests of its owner, give publicity whenever there is regulation in that sense (such as the publication of balance sheets for some kind of companies), and use their means of production freely.
SOEs, although part of the public administration, are subject to a “hybrid legal framework,” meaning that in some aspects they have to observe the public administration principles, and in others, they must apply the rules related to private enterprises. Table 1 presents the main differences and similarities between public administration, private enterprises, and SOEs. Each of the subjects is going to be detailed ahead, in a way that makes clearer the difference between the regulations applied to the public administration entities and the ones that are applicable to SOEs.
<table>
<thead>
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<th>Subjects</th>
<th>Public Administration</th>
<th>Private enterprises</th>
<th>SOEs</th>
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| **Procurement regulation** | Strict rules (law 8.666/93) when buying or selling goods | Can buy and sell in whatever way they want | Buying: has to observe strict rules (law 8.666/93)  
Selling: private rules |
| **Workforce legislation** | Strict rules (law 8.112/92)  
Hiring: as a general rule, has to be through public selection but admits Dismissal: due process of law | Private rules (CLT\(^{20}\))  
Free for hiring and dismissal (observing the compensatory nature when applied) | Hiring: as a general rule, has to be through public selection  
Wages, dismissal and other aspects: private rules (CLT) |
| **Budgetary Process** | Congress has to approve all the expenses | Not subject to public approval | Congress has to approve the total investment, but there is no detail of the expense |
| **Transparency** | Subject to full divulgation of the revenues and all the expenditures of the government.  
All the acts have to be published in an official journal.  
Public servants salaries are published on a regular basis.  
The community is allowed to request information of the government. | Only subject to accounting disclosure for tax authorities, criminal investigation or when open stock rules demand the publication of balance sheets. | Subject to publish on the Internet all expenditures, procurement and contracts.  
Public employees salaries are not published.  
The community is allowed to request information, but commercial secret can be alleged. |

\(^{20}\) Decree Law 5.452/43 – Consolidation of the Labor Laws (Consolidação das Leis do Trabalho - CLT).
4.1. Procurement regulation

According to the Brazilian Constitution, public works, services, purchases, and sales shall be contracted through a public bid. In practical terms, this means that the public administration is subject to a strict procurement regulation, being the 8.666/93 the most important law in this aspect. According to this law, the procurement process’ purpose is to make sure that everyone interested has the same chance to make its offer and select the best purpose for the public administration. In other words, a procurement process cannot impose on unjustified restrictive requirements and has to choose the best offer presented by the participants, in a way that the government purchases the best service or good for the cheapest price.

The Constitution establishes that SOEs are allowed to have a less strict procurement process, but it would have to be regulated by a law approved by the Congress. Nonetheless, until today, only Petrobras has been granted a specific regulation for its procurement process. All other public companies are subject to the same regulations applied to all other public entities. The only exception is when a SOE is selling its products or part of its capital. In these cases, the SOE does not have to apply any special rule, differently from what happens to the rest of the public administration when selling a public building, for example.

Brazilian procurement processes have been so heavily regulated that one could imagine that it would be almost impossible to be subjected to fraud. Unfortunately, reality shows a different scenario. A lot of corruption cases in Brazil are related to misconduct in procurement procedures. Data published by the Office of the Comptroller General\(^21\) show that there are almost 9,000 persons and private enterprises suspended or debarred from participating in public bids, due to illicit acts against the procurement process law.

Most of the fraud in procurement is related to the requirement of unnecessary qualification to the participants in an attempt to directing who is going to win the process. In other words, requirements are made in such extensions that few (or even just one) enterprises can match them, and thus take place in the bidding process. In that situation, investigations have found various cases where an enterprise bribes public officials in order to submit which restrictive clauses should be addressed on the procurement process, and then be the only one with conditions to be chosen.

Another very common illicit act is the purchasing of a product with an overpriced value. In this case, public officials allow the hiring of a private enterprise that is overcharging the government, expecting to receive part of the money that is being overpaid.

In relation to procurement, there is no difference between the rule that is applied to the SOEs from the one that is subject to the public entities. As a matter of fact, there is also little evidence that corruption related to the purchasing of service or goods is higher in SOEs in comparison to other public agencies or departments.

But what calls attention to the specific situation of SOEs is the large amount of money that is in their control and subject to much more discretion of allocation but much less accountability.

4.2. Workforce legislation

Labor legislation is a subject that presents more differences between SOEs and other public entities than does procurement. Nonetheless, the problem related to corruption in both kinds of institutions seems to be the same.

In a general sense, SOEs and the rest of public administration are subject to the same rules regarding the hiring process. All of them have to promote public selections in order to hire permanent personnel to its workforce. However, once they are hired, the employees are subject to different regulation: SOEs have to apply the same labor legislation
that is applied to the private enterprises, while the other public entities are subject to a special law, called the statutory regime. The personnel of SOEs are called “public employees” and the ones from the rest of public administration are called “public servants.”

Beside remuneration and pension aspects, the main difference between those two kinds of regulation is stability. Public employees, by the law, do not have stability and because of that, they can be dismissed at any time and guaranteed the same compensatory payments that are due to a private worker. Meanwhile, after working three years at the same position, public servants are granted stability and can only be fired after due process of law.

Nonetheless, dismissal of public employees related to poor performance are hard to achieve and, recently, the Brazilian Supreme Court has decided that a dismissal of a public employee must be justified, which, in practical terms, means that it should be preceded by due process of law. In this sense, the differences between the workforce legislation are not significantly important. In fact, corruption involving the hiring or dismissal process in Brazilian government does not seem to be an important issue with regard to its permanent and technical workforce.

Corruption seems to be mostly related to the way that the high rank positions of the government are chosen, regardless if in SOEs, ministries, departments, or agencies. In that case, the President and ministers are free to appoint whomever they want to serve at their pleasure. In some cases, especially in regulation agencies, some high posts are subject to Senate approval, which, in reality, does not seem to affect political designations that lack technical knowledge for the position.

However, the political influence on appointments seems to be more harmful in SOEs when focusing on its Board of Directors (Board). In general, all Brazilian SOEs have a Board that is supposed to be an autonomous body responsible for the definition of the main

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22 The public administration can also hire people for a specific period, in a different legal regime, but this category is not especially important for the purposes of this paper.
goals of the company and to oversee and evaluate the performance of the Executive Board. In SOEs that are also public capital companies, for instance in which the State has most of the stocks but there are also private investors, the Board is appointed mostly by the government, but there are also members appointed by the common and preferred shareholders. In SOEs where the state is the only owner, the government appoints the whole Board.

As an autonomous body, the Board is supposed to be unbiased in its judgments, looking only for what is best for the company. But that is not what seems to be the case in Brazil’s experience. In most important SOEs, the Board and the Executive Board are directly appointed by the president, which clearly affects the impartiality of the overseeing process and, ultimately, the corporate governance. Table 2 presents how is defined the composition of the Board.

The table shows that, in all cases, the majority of Board members are directly appointed by the State. Furthermore, in all SOEs presented, the President of the Board is a Minister or a Vice Minister. One could argue that this is an expected situation: Once the State owns the company, it gets the right to choose the people who are going to run it. The problem is that if the government wants to use the company merely as a way to receive political returns, there will be no institutional instrument to prevent that from happening. Why, then, would a Minister, directly chosen by the President, be against an investment decision that would be a bad deal for the SOE but politically appealing for the party in charge of the government?

In the previous discussion, the social perspective of SOEs stated that sometimes these companies are ways for the State to achieve economic development in sectors or regions where the private investment would have no interest to take part. That way, the SOE could make investments that are bad from the perspective of the enterprise, but, in the long run, would benefit the community. Yet this is not the situation that is being challenged here.
Without getting in the discussion related to whether the SOE would be the best instrument of dealing with this kind of development problem (keeping in mind that the government could use other ways of achieving the same goal, such as subsides or other kind of incentives), the concern here is a political use of the SOE without any commitment towards the performance of the company or a sustainable social project for the community.

The same political influence is seen on the process of choosing the CEO, the Executive Board, and other strategic management positions. It is important to keep in mind that sometimes the appointment will not necessarily be over a person who is from outside the SOE. Different corruption cases have shown that the political support can be given towards a public employee that belongs to the technical workforce of the company, but has to rely on the aid of politicians to climb up the hierarchy. Unfortunately, being selected among the technicians does not seem to be the antidote against corruption, as some examples will be shown later on in the paper.
**The stock participation of the State in such SOEs can be above 51% and is volatile, but it never less than 50% and always has some private participation.**

<table>
<thead>
<tr>
<th>Subjects</th>
<th>Petrobras</th>
<th>Infraero</th>
<th>Eletrobras</th>
<th>Correios</th>
<th>Banco do Brasil</th>
</tr>
</thead>
<tbody>
<tr>
<td>Shares held by gov’t</td>
<td>57%*</td>
<td>100%</td>
<td>78%*</td>
<td>100%</td>
<td>68%*</td>
</tr>
<tr>
<td>Number of directors</td>
<td>Ten directors</td>
<td>Seven directors</td>
<td>Up to eleven directors</td>
<td>Seven directors</td>
<td>Eight directors</td>
</tr>
<tr>
<td>Designation</td>
<td>7 are appointed by State 1 by minority common shareholders 1 by preferred shareholders 1 by employees.</td>
<td>4 are appointed by the Minister of Civil Aviation 1 by the Minister of Defense 1 by the Minister of Planning 1 by the employees</td>
<td>6 are appointed by the Minister of Mines and Energies (one being the President of the Executive Board) 1 by the Minister of Planning 1 by minority common shareholders 1 by preferred shareholders 1 by employees 1 independent</td>
<td>4 are appointed by the Minister of Communications 1 by the Minister of Planning 1 by the employees 1 is the President of the Executive Board</td>
<td>3 are appointed by the Minister of Finances 1 by the Minister of Planning 1 by the employees 2 by minority common shareholders 1 is the President of the Executive Board</td>
</tr>
<tr>
<td>Current president</td>
<td>The Minister of Finances</td>
<td>The Vice Minister of Civil Aviation</td>
<td>The Vice Minister of Mines and Energy</td>
<td>The Minister of Communications</td>
<td>Vacant, the last president was the Vice Minister of Finances</td>
</tr>
</tbody>
</table>
4.3. Budgetary process

One of the main differences between the legal framework of SOEs and the other public entities is the budget process approval. It is important to highlight that there are two different kinds of SOEs when studying the regulation related to budget rules: self-sustainable SOEs and dependent SOEs. The former are ones that, because their activity, can manage to obtain revenue by themselves, and the latter do not generate revenue at all or at least not in a sufficient amount to provide itself alone. In the latter case, the SOEs are directly subsidized by the government thus are subject to the same budgetary rules applied to other public entities. From this point beyond, then, whenever explaining the differences between the budgetary processes, the reference is to the self-sustainable SOEs, which are the majority kind of public companies in Brazil.

The general rule of the public administration budget is that it has to be approved by Congress in a way that all expenditures are detailed and the government has to follow that command. If the Executive Branch wants to change a kind of expenditure, it has to submit its intention to a prior approval by the Congress.

Although the budgets of SOEs also need to be approved by Congress, the main difference is on its level of detail. Since the SOEs, at least the self-sustainable ones, do not rely on revenues provided by tax money for its ordinary expenditures (at least in normal conditions), Congress must only approve the total amount of money that is going to be spent in that year in investment by the public companies. In this way, once the budget is approved, the SOEs have much more discretion on choosing where to apply its revenue than the other public entities that have to submit a much more detailed proposal to the approval of the

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23 The Brazilian Ministry of Planning publishes the list of all SOEs: 
Congress. Just to stress how relevant the budgetary process is to SOEs, its total investment budget for the year of 2012 was about 54 billion dollars, corresponding to 13 percent of all money invested in Brazil.

It is important to state that the Brazilian budgetary process model is not bad because of the discretion that is granted to the SOEs. Once they have to operate in markets and deal with situations that are volatile, it would not be reasonable to submit every investment decision of a public enterprise to the decision of Congress. If that were the way, SOEs would inevitably be much less inefficient and probably without conditions of competing with private enterprises.

But it is interesting to notice that, once the SOEs have such discretion on deciding its investment, there is even more responsibility and concentration of power on its Board, CEO, and Executive Board, that, as seen before, tend to be chosen based on political criteria alone.

**4.4. Transparency regulation**

In the past ten years, the Brazilian Federal Government has demonstrated a considerable effort in improving its transparency towards society. Among other actions, it is relevant to point out that, in 2004, the Executive Federal Branch launched a website called Transparency Portal (‘Portal da Transparência), an unique tool that provides detailed information of every kind of revenue and expenditure made by the public administration and is updated on a daily basis. The same website also provides information about the public servants’ salaries, administrative sanctions against enterprises and public agents, and information about the people who benefit from cash transfer programs. The information published on the Transparency Portal is available to anyone with access to the Internet.

Although the Transparency Portal does not provide information about self-sustainable SOEs (only about the dependent ones), they are required to publish on their own
websites some information that also gives a high degree of transparency. Due to presidential
decrees, SOEs have to publish detailed information about their expenditures, procurements
and outsourcing contracts. However, even though the decree dates back to 2005, until 2012
was relatively common to find reports from The Office of The Comptroller General (CGU)
pointing out that several SOEs had not yet managed to fulfill all the demands for more
transparency.

It is also relevant to say that, in the same way as the other public entities, SOEs
are also subject to auditing from CGU and from the Federal Court of Auditors (TCU), and
their reports have to be available online. Despite the existence of some complains of the
auditors that sometimes SOEs are too resilient in providing all the information required,
several works done by the CGU and TCU raised important red flags that led to the
improvement in governance process and even to criminal investigation in such companies.

Another important aspect is that the implementation of the Freedom of
Information Act in Brazil has demonstrated that SOEs sometimes can allege that some of its
information is not subject to full disclosure. Enacted in 2011 (12.527 Law), the Brazilian
Freedom of Information Act establishes that, as a general rule, all actions and data produced
by the government should be public, and any citizen has the right to demand information to
public entities. As exceptions, the law admits that some information could be classified as
secret, if its publication could, for example, harm the safety of the nation or the conducting of
international negotiations or investigations relative to illicit acts. The same law also admits
that information regarding industrial or commercial secrecy of SOEs is not obliged to be
published or provided upon request.

24 5.481 and 5.482 both of 2005.
25 Several reports of CGU have indicated that some SOEs have presented obstruction to the auditing
process, such as in Banco do Brasil, BNDES and Petrobras.
26 For some special works done by CGU in SOEs: http://www.cgu.gov.br/assuntos/auditoria-e-
fiscalizacao/acoes-investigativas/operacoes-especiais
CGU’s report of the implementation of the Freedom of Information Act\textsuperscript{27} points out that, on average, the Federal Executive Branch grants the information required 75.5\% percent of the time, and only denies it in 11.2\% of the cases.\textsuperscript{28} In the case of SOEs, they attend 71.2\% of the requests, but deny 17.7\% of them, showing a lower ratio of positive replies. In almost 50\% of the cases that the requirement was denied, the SOEs argument was that the information required is secret due to industrial or commercial secrets. Another important aspect is that, on most of the SOEs official websites, it was not possible to have online access to the meeting minutes of the Board of Directors, but that does not mean that it would be denied if it were to be formally requested. In the same sense here presented, it is also possible to see complaints from the press about the lack of interest from SOEs to become more transparent.\textsuperscript{29}

Nonetheless out of all the issues related to the lack of transparency in SOEs, it was also possible to observe that some SOEs have made progress in becoming more transparent to society by publicizing its acts. Although there seems to be a general sense of caution towards the disclosure of some types of information, most of the SOEs have been submitted to regular auditing. It was also possible to access a wide range of information related to their procurement processes and contracts made, even though it took several years for that to become possible.

Transparency seems to be especially important for public entities. On one hand, by making its acts public, SOEs helps the taxpayer keep track of where his money is being spent and discourage corruption. On the other hand, becoming more transparent imposes costs to the public companies that are not subject to the private ones. The process of transparency

\textsuperscript{27} Available in http://www.acessoainformacao.gov.br/central-de-conteudo/publicacoes/relatorio-2-anos-lai-web.pdf

\textsuperscript{28} Other situations may occur, such as the inexistence of the information required, a duplicate request or the information is not in power of the entity demanded.

also imposes more bureaucracy that will not necessarily prevent corruption to the same extent and thus, can drive inefficiency if compared to the private companies that do not have to spend money with such kind of measures.

4.5. Analysis on corruption

As state previously, this paper aims to apply Robert Klitgaard’s corruption analysis framework toward some corruption cases that took place in Brazilian SOEs. The previous topics have explained some legal issues relative to SOEs that can help better understand why corruption seems to happen so often in Brazilian public companies.

According to Robert Klitgaard, corruption is more likely to happen whenever there is a monopoly power with great discretion and low accountability. As it was demonstrated, SOEs concentrate a great amount of monopoly power. For the year 2012, 54 billion dollars were at the control of SOEs—this is just the investment budget, which does not include ordinary expenses that in companies as big as Petrobras, Banco do Brasil, and Correios, which would otherwise can reach a more expressive figure.

The impressive amount of money in control of SOEs is also followed by more discretionary rules than the ones applied to the rest of the public administration. For instance, only the SOEs investment budget is subject to congressional approval and not to a high detailed level, which gives more room to SOEs directors decide where to apply the money. Also, the investment expenditures of most of the SOEs are not ordinary. Since they are specialized in different markets, each public company makes purchases and contracts in sectors that demand a more specific knowledge, which can give space to a wide range of technical arguments to explain its decision of expenditure and is hard to discern the bad deals from the good ones. The same result appears in procurement processes. Even though most SOEs are submitted to the same procurement regulations that other public entities are also subject to, the Brazilian Law has not been able to prevent corruption from taking place.
Procurement regulation has been so extensive and detailed that it makes the purchase process difficult to understand and exposes it to fraud.

In the same sense, accountability seems to be undermined in SOEs. Although SOEs are subject to auditing and Congress oversees them, the most important instrument of supervision of the SOEs should be its Board of Directors. Unfortunately, the decision process of the appointment of the SOEs Board and all its other high-ranking positions are politically contaminated, which weakens the accountability process. At the same time, some improvement on transparency has been found, but has been mixed with demonstration of caution towards a more flexible disclosure of its data.

Having set up the framework of analysis, the next chapter will go through some major corruption cases that took place in Brazilian SOEs as a way to try to apply the theoretical view that has been proposed here (see Table 3).

<table>
<thead>
<tr>
<th>Table 3. Corruption analysis framework overview</th>
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<tbody>
<tr>
<td>Aspect</td>
</tr>
<tr>
<td>Monopoly power</td>
</tr>
<tr>
<td>High discretion</td>
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<td></td>
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<tr>
<td></td>
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<tr>
<td>Low accountability</td>
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</table>
5. BRAZILIAN SOEs AND CORRUPTION SCANDALS

5.1. The mensalão case: Brazilian Postal Service (Correios) in its origin

The mensalão\(^{30}\) case is seen as the largest political corruption scandal in Brazilian history.\(^{31}\) In most of the historical reviews about the case,\(^{32}\) it is said that the scandal became public when Roberto Jefferson, President of the government allied Brazilian Labor Party – PTB, claimed in a newspaper interview that the PT (Workers Party, the party of the president at that time, Luis Inácio Lula da Silva) was paying several Congressmen 30,000 reais a month (around $12,000 at the time) in return for support for its legislative agenda. The money was said to have come from the public, acquired from fake advertising contracts signed by state-owned companies with corrupt advertising firms and other kind of contracts.

However, the case actually has its origin in an event that occurred just before the scandal. On May 14, 2005, Veja, a Brazilian weekly magazine, published a story describing an apparent corruption scheme in the Brazilian Postal Service, or “Correios,” which is owned and run by the State. The magazine described the content of a video tape recording, made with a hidden camera, which showed a Postal Office manager, Maurício Marinho, apparently receiving a bribe from a businessman. In the tape, Marinho said that he charged a bribe for all the contracts that he was responsible for, and the money was meant to go to the parties responsible for both his nomination and his superiors’ nominations\(^{33}\) (at the time, Marinho was under the orders of the Vice-President for Administration Management).

The scandal was the first of many that broke out in quick succession. Quickly, other allegations become public that the state-run postal system had accepted bribes for

\(^{30}\) A Portuguese neologism roughly meaning “big monthly stipend”.


contracts, and that the PT had been extorting money from procurement in other public firms (such the Furnas, an electric power company). The issue was brought to Congress whereby it was decided that a parliamentary committee of inquiry (CPI) would be initiated to investigate the case. Congressional inquiries ended up accusing eighteen congressmen of involvement in the vote-buying scheme, among other high-ranking public officials of different several public entities that were then criminally prosecuted.

By the end of 2013, after a long trial held by the Supreme Court, 25 of the 40 defendants had been found guilty of crimes including bribery, money laundering, misuse of public funds, and conspiracy, and most of them were sent to jail.

Referring specifically to the Postal Service, a huge auditing service was conducted by the Office of The Comptroller General (CGU) with the intention to find out irregularities on the contracts made by that SOE. CGU pointed out 110 misconduct findings that suggested the need of punishment for the public employees involved. Investigations conducted by CGU with the help of the Federal Policy pointed overpriced contracts and procurement processes that were illegally targeted to benefit some private companies. One of the most shocking pieces of evidence collected by the investigation was an Excel table kept by Marinho in his work computer where he kept track of all the information regarding the Postal Service contracts (e.g., the total amount, time length, performance and, surprisingly, what the percentage of the money paid should go to his supporting party).

The investigation showed that Marinho and his boss held great power deciding which companies were supposed to win the procurement process and, after that, they could negotiate the bribes that had to been paid directly to them. Event though each purchase was regulated by strict laws, evidence demonstrated that some illegal conditions were made in

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order to favor specific companies. Another method of corruption was allowing the winner of the bid to deliver products that did not match the quality required. Another interesting fact was that some purchases made by Correios required a high degree of technical knowledge that made it hard for auditors to point out illegal behaviors. An example of that was the hiring of a new solution to issue remittance of bills, such as credit cards and other bank expenses, without having to mail it directly from its origin. This was called the “Hybrid Postal Project” (Correio Hibrido). In other cases, procurement could be related to more ordinary goods, such as envelopes, but the illegal practice would be done only when the product was delivered, and when the company would pay off the employee responsible for checking its quality.

With more than 350 years of existence, Correios is Brazil’s oldest SOE and has more than 120,000 employees. Even though the service of package delivery can be done by any private enterprise, Correios holds the monopoly of mailable matter (such as letters and telegrams). For the year 2013, Correios had a total of 14,793,300,000 reais in net earnings. Since Correios is a self-sustainable SOE, its expense budget does not have to be approved by Congress in a detailed level. Its Board of Directors is composed of seven members, and six of them are appointed directly by the government; its employees choose the remaining one. However, it seems that the positions most coveted by the politicians are the ones on the Executive Board, in other words the CEO and seven Vice-Presidential positions.

5.2. “Aviation Blackout” case: Infraero under investigation

The “aviation chaos” or “aviation blackout” was the name that the media used to refer to the crisis that befell the Brazilian air transportation sector in 2006 and 2007. The crisis started with a major aviation accident that led to a huge manifestation by the air-traffic controllers. After the accident, the controller feared an operational failure and, due to the difficulty to communicate with the authorities, reacted by starting a work-to-rule protest (“white strike”) which, coupled with insufficient personnel, led to the lack of operational
control in the main airports in the country. Causing great loss for users. During the crisis, a new airline accident brought the Brazilian public opinion to doubt the structural and professional efficiency of an area that had so far been considered safe, even by international standards.

Due to the crisis, the Brazilian Congress chose to initiate a parliamentary committee of inquiry (CPI). While investigating the causes of the accidents, the Congressmen also put their efforts in looking to blame the government for the crisis. Until then, almost all Brazilian Airports were built and administrated by Infraero, a state-owned enterprise. Because of the crisis, the media and society also started to challenge the quality of the airports and the public money put toward this kind of service.

The investigation conducted by the CPI focused on three different aspects: the purchasing of an advertisement management software; irregularities on the construction or rebuild of 16 airports; and the selling of ad space in airports. Once again, the investigations also took in consideration previously auditing workers done by the Office of The Comptroller General and the Federal Court of Auditors.

The conclusions of the CPI were astonishing. In its final report, the CPI concluded that Infraero was suffering from an endemic and systematic scheme of corruption. The private interests of firms that maintained contracts with Infraero were overwhelming the public interest, that which was supposed to be protected by the SOE. Deals were made not with the motive of efficiency but only with the intention to benefit private companies.\(^{36}\) Eleven high ranking officials of Infraero were appointed as having practiced irregularities on choosing which private firms should get the most profitable contracts. Although there was a huge suspicion that part of the money was also directed to the parties that supported the

\(^{36}\)“Relatório Final CPI ‘do Apagão Aéreo’.”
appointments for the higher posts in the executive board and other strategic management positions, the investigation could not be conclusive over this allegation.

Similar to the Correios case, some of the illegal events were related to purchases that required a very specific knowledge in order to take place. That was the case of the purchase of the advertisements management software, which was unique in the Brazilian public administration as well as involved the hiring of a reinsurance broker to act in name of Infraero. In both cases, Infraero Directors tried to present technical reasons to justify their acts, but the investigation pointed out that the companies that won the procurement process were linked to politicians that were also related to the appointment of several Directors of Infraero.

Infraero was founded in 1973, as the public company responsible for building and managing almost all Brazilian airports. Nowadays, it has under its management 60 airports, and 28 cargo terminals. For this purpose, Infraero has 12,850 employees throughout Brazil. Historically, the Board of Infraero is headed by the Minister of Defense and, after its creation, by the Minister of Civil Aviation or someone very closed to those authorities.

Because of concerns of another crisis in the sector, especially with the hosting of The 2014 World Cup, Brazil’s government started a privatization process of the airports in the year 2012. Through this process, five major airports are now under private control. Nonetheless, because of the government decision, Infraero holds 49% of the shares of the five privatized airports, holding the power to appoint some members of the Board of Directors of the companies in charge of those airports.

5.3. The same story still goes on: Petrobras scandal in 2014

In the first semester of 2014, the Brazilian press started to publish several news stories regarding suspicious deals made by Petrobras, an oil company and biggest Brazilian SOE, that were done in benefit of the Workers Party (PT). The news focused, initially, on the
purchase by Petrobras of an oil refinery located in Pasadena, Texas. The negotiation was told to be an extremely bad deal for Petrobras that would have paid too much money for an unprofitable refinery, in a way to funnel money from the SOE to politician pockets.

Later on, newspaper reports focused on several other negotiations made by Petrobras that raised the suspicion of corruption acts. Again, another refinery purchasing, that time in Japan, was told to be a bad decision made by Petrobras because the high price paid and the low profit expectations. Again there were suspicions that the negation was intended to mask money away from Petrobras and go to parties allied with the government.

In another episode, investigations, still in progress, led by the Dutch government initially pointed the suspect that SBM, an important trading partner of Petrobras, had paid bribes to Directors of the Brazilian company.

Relating to domestic business, the press called attention that the Brazilian Federal Court of Auditors have found, through the past few years, several irregularities on the construction of local refineries (such as Abreu e Lima, one of the most expensive projects of Petrobras) and oil ducts.

At the same time, a criminal investigation, conducted by the Federal Policy, lead to even more astonishing findings. The investigation into money laundering, known as Lava Jato (“Jumbo Wash”), implicated Paulo Roberto Costa, a former member of the Executive Board of Petrobras for receiving and sending money abroad without properly reporting it. Soon, the money transactions were linked to his former role in Petrobras. Looking for reduced prison term, Mr. Costa made a leniency agreement and testified against other people involved in the corruption scheme. Although his testimony has not been officially publicized yet, according to different newspapers, Mr. Costa who ran Petrobras’s refining division from 2004 to 2012, has accused more than 40 politicians of involvement in a vast kickback scheme. The list reportedly includes a Minister, three state governors, six senators and dozens of
Congressmen from President Dilma Rousseff’s Workers’ Party (PT), and several coalition allies. The beneficiaries are alleged to have pocketed 3% of the value of contracts signed with Petrobras in return for supporting the government in congressional votes.

Due to all the repercussions of the Petrobras case, the Brazilian Congress established a parliamentary committee of inquiry (CPI) with the purpose of investigating all denunciations. Even though CPI rarely manages to achieve important conclusions toward corruption cases, they give a strong political appeal towards the case and try to drive the implications to damage the image of some politicians and benefit others.

Meanwhile, Petrobras, one of the biggest oil companies in the world, faces several losses. Investors are afraid to put money in an enterprise that is subject to political interference, deals are cancelled and projects are delayed while investigations are conducted, and the fear of new corruption reports remain in the air. Chart 1 presents how Petrobras share prices have fluctuated over the past seven years according to important events related to the SOE.

**Chart 1. Petrobras share price.**
5.4. Analysis framework in practice

The three corruption cases present useful perspectives to test the analysis framework suggested by Robert Klitgaard. At first, it is possible to point out that all of the three SOEs involved in the cases hold high monopoly power regarding the possibility of having great amounts of money available for investment projects. Even though the decisions related to important projects have to be submitted to the approval of the Executive Board or to the Board of Directors, investigations have demonstrated that some employees in key management positions were able to interfere directly in procurement processes in a way to make corruption acts possible.

In the same sense, some employees managed to hold high discretion in the decision making process by presenting technical arguments that were difficult to be challenged. Also, as it occurs in every self-sustainable SOE, all the public companies did not have to submit its expenditures, at least not in a high detailed level, to the approval of Congress.

Both elements help explain the reason why such SOEs were exposed to corruption acts. However, they do not seem to be the most important aspects of the corruption phenomenon. Other kinds of public entities and private companies also have to deal with transactions involving significant amounts of money and this does not necessarily mean that corruption will take place. In these cases it is also possible to observe some people hold more discretion over decisions without having been subject to bribes. In the same sense, Congress’s prior approval of all the expenses of SOEs does not seem to be an efficient measure and surely will not be the solution for corruption.

Actually, the element that has been more predominant in corruption cases is the political influence over SOEs. Once the government holds the capability of appointing all the important positions in the public companies, especially the Board of Directors and the Executive Board, the accountability process is weakened to a great extent. Without an
institutional instrument of making the SOE pursue its main goals, SOEs can be driven to look for political results that will not necessarily deliver good returns to society.

The political interference over SOEs plays an important role over the governance process in Brazil. Actually, Latin American governments have always been strongly executive centered. Having multiparty political systems, history has demonstrated that presidents in Latin American and Brazil alike have struggled to achieve good governance. Usually, as a way to have majorities in Congress, presidents in Brazil tend to form coalitions based on various parties and then have more of a chance to succeed in approving its legislative agenda. Pereira e Melo have stated that coalition-based multiparty presidential regimes succeed if the president is constitutionally strong, has “goods” to trade in order to attract and keep coalition partners, and faces institutionalized and effective checks on presidential actions. Unfortunately, the trade of “goods” is not necessarily related to the discussion over different views of public policies. Usually, the “goods” exchanged in return for legislative cooperation include cabinet posts and pork barrel projects.

As was seen in the examples of corruption cases, all the situations had the involvement of politically appointed officials. In these cases, there was lack of interest in adopting measures of preventing fraud and thus room for corruption take place in order to provide money to the political parties. For the same reasons, the oversight process was flawed once the Board of Directors was predominantly occupied by officials with strong links to the government and little motivation to interfere on the administration of the SOEs.

37 Close, 2009.
38 Pereira e Melo, 2012.
6. PERSPECTIVES FOR SOLUTIONS: CHANGING THE INSTITUTIONAL FRAMEWORK OF SOEs?

Several characteristics of SOEs can help explain why the corruption cases analyzed took place in such institutions over the past years. Determinants like monopoly power and high discretion, low accountability, and severe political interference, seem to be plague environments with corruption.

Having reached this conclusion, the next question to be addressed should be related to the measures to prevent corruption from taking place in SOEs. The simplest answer can be based on Huntington’s perspective: If corruption usually took place when there is government interference, the privatization of SOEs could be the easiest way from preventing the misuse of these companies.

However, this is a path far from the actual trend in Brazil. After Cardoso’s administration when various privatizations took place, the governments of Lula and, after, Dilma have gone in down different paths. The PT administration has reinforced the role of SOEs and even created new ones, with the exception of the privatization of some public roads and airports.

Also, the historical process of the Brazilian public administration has shown that the population tends to put high expectations on the role of the government, and SOEs are especially important in this process. The population sees some of the SOEs as instruments of the economic development of Brazil and their privatization usually can appear as unpopular measures. Another issue is that sometimes, SOEs provide services that are unprofitable or not in the interest of private investments, but are still important for the population. Sewage treatment, electricity and water distribution are among the services that the State has to provide to the society even if it is not a profitable activity.

With this perspective in mind, maybe the middle ground could be a possible solution. First, the SOEs should be distinguished in two different groups: the ones that are
seen as profitable (such as oil exploitation and airport management) and the ones with low profit perspectives and low interest by private investment (such as postal service and energy distribution in remote areas).

Holding the idea that the government see SOEs as important instrument of development and still wants to secure some control over them, the profitable SOEs could be partially privatized, in a way that the government could still hold some important positions in its Board of Directors and therefore take part on the decisions of the company. However, the administration of the company would have to be shared with the private interest, assuring that it would still pursue profit, more efficient processes, and avoid political appointments that could lead to corruption. This path has already been taken in other cases by the Brazilian government with good results. That were the cases of the privatization of Vale do Rio Doce (mining company) and some airports, when the State remained as a minor investor of the companies and they are directed by private investment.

On the cases of the unprofitable SOEs, the government will have to develop institutional instruments that can guarantee a professional management of the public companies. Those measures cannot seek more strict regulation and bureaucratically measures under the argument that will improve the administrative controls. The experience has shown that more regulation increases inefficiency and sometimes makes easier to corruption take place instead of preventing it. Because of this, the SOEs would have to be subject to professional appointments to its keys management positions instead of political ones. And, above of all, the Board of Director should be composed by independent members with steady mandates and holding the mission to seek performance goals set by the government with the participation of the Congress. That way, instead of having to approve and manage every investment decision of the SOE, the government and Congress would merely designate the
goals of the companies and make sure that the Board of Directors holds responsibility for not achieving the objectives established.
CONCLUSION

The main goal of this paper was to discuss the main reasons that can explain why some corruption cases took place in Brazilian SOEs over the past few years. Even though, it was not the intention to compare if SOEs are more susceptible to corruption than other public entities, it was possible to point out some of its characteristics that help understand some corruptions schemes that happened in those companies.

In the first chapter different views were studied as a way for a better understanding of the concept of corruption. Although each approach focus in a more specific and different aspect, it was possible to show that the society tends to see corruption as a phenomenon harmful for the social development, especially if there are public officials involved with the illegal acts.

The second chapter presented a discussion over how corruption is related with the economic development of a country. Opposite opinions were provided to a better understand of the “grease on the wheels” and “sand on the wheels” hypothesis. Regardless the position of some scholars that corruption could be at some point beneficial to improve government bureaucracy, nowadays, there is a general consensus in the academy and in the international community that corruption undermines economic development and consists a barrier to free markets.

Chapter three brought the historical process of the public companies and the various theories that try to explain why they are created or privatized over the years. The Brazilian history demonstrates that SOEs were used as important instruments of economic development, and, despite the strong process of privatization over the 90’s, SOEs play a strategic role for government still nowadays. Chapter three also gives an overview of the legal framework of SOEs in comparison with the other public entities and private companies.
Chapter four introduced Robert Klitgaard analysis framework for the corruption phenomenon. With this concept in mind, chapter four discussed four distinctive characteristics of SOEs that proved to be important to understand why SOEs are susceptible to corruption acts. The strictness and difficulty to apply procurement regulation, the control of a high budget, the low level of transparency, and, above of all of those, the lack of barriers to political appointments to key positions, appear as elements that fit under the Klitgaard’s corruption analysis framework.

The goal of chapter five was to give an overview of three important corruption cases that took place in different Brazilian SOEs but presented some similar characteristics that reinforced the usefulness of the analysis framework used in this paper. Although all the elements analyzed on the previous chapter were seen on the corruption cases examined, the political interference seemed to be the most determinant.

It is important to establish that corruption is a phenomenon that can be studied from different perspectives and several factors have to be taken in account to a better understanding of its occurrence. The analysis provided by this paper has a range limitation, in a sense that the institutional and legal framework were the elements chosen to be studied. Other issues, such as the lack of effective criminal responsibility or flawed laws, are also important to study the reason why corruption takes place that, however, due to its limitations, this paper had to left aside those matters for further future studies.

Having reached the conclusion that SOEs should be less susceptible to political interference, chapter six presented two suggestions of measures that could be taken in order to prevent corruption in SOEs. The first one is addressed to the profitable public companies. Keeping in mind the possibility that there would exist private investors interested on taking control of those companies and that the government would still have reason on trying to make them act towards social purposes, the suggestion is that State should act as a minor investor in
those kind of SOEs. This way it would be expected that the companies would achieve more efficiency management once they would pursue more profit and, at the same time, government could still have some influence towards key projects of the enterprise, by appointing some positions at the Board of Directors.

The other suggestion focus on the non-profitable SOEs. Since some SOEs perform activities that are not on the interest of private investors, but are important to society, the government should still keep control of those enterprises. Nonetheless, in this case institutional framework should be designed in a way to make sure that the public company would pursue efficiency while seeking the task in its responsibility. For that, the Board of Directors should be composed by members from outside of the government and steady mandates, which, with independency, would have to chase the performance goals established by the President with the approval of the Congress.

Regardless the trend on most development countries to have few public companies, Brazilian government does not seem to be in a movement of pulling out its presence on the economy. Nowadays it is hard to imagine that SOEs could be led to a privatization without a strong political willing toward this path that could also deals with the expected discontentment of the general population with those kind of measure.

Since there appear to be a lack of interest on the privatization of SOEs, and also because such a measure would have to take several other issues in account, Brazilian government has to pursue effective actions to fight corruption in public companies. The corruption cases that took place recently on Brazil show that they were not ordinary or isolated. Public funds were taken from SOEs by its highest-ranking officials in a process directly linked to provide cash to political parties. Grant corruption cases have to be dealt with measures that change the institutional framework of the entities involved in such way that makes it hard to happen again. Minor changes in legislation, submitting SOEs to more strict
regulation does not seem to prevent corruption more than lead to greater inefficiency. Brazilian government should establish institutional forms to prevent SOEs from being subject to the volatile, and in some cases malicious, will of politicians.
REFERENCES


