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Telebras Privatization Becomes Campaign Issue in Brazil

by LADB Staff

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On June 10, the Brazilian government set the base price for the sale of the giant telephone company Telecomunicacoes Brasileiras (TELEBRAS) at US\$11.7 billion, considerably less than anticipated just a few months ago. The lower-than-expected base price has pushed the TELEBRAS privatization to the forefront of the presidential-election campaign, with the opposition accusing President Fernando Henrique Cardoso of trying to use the sale to finance his campaign. Until May 22, TELEBRAS, created in 1972, comprised 27 regional phone companies. In May, stockholders approved dividing the company into one long-distance, eight cellular, and three fixed-line companies to prepare it for privatization.

Twelve domestic and foreign companies have registered to participate in the auction, scheduled for July 29, among them US firms MCI, Sprint, Southwestern Bell, and Air Touch. Others include Bell Canada International, Telefonica de Espana, France's Telecom, Italy's Stet International, and Portugal's Telecom. Communications Minister Luiz Carlos Mendonca de Barros said the Europeans are the most likely buyers. "They realize that this is a unique opportunity," he said. Although analysts said they consider the price fair, it is far less than the amount suggested by former communications minister Sergio Motta. Motta, chief mover of the plan to privatize TELEBRAS, said in March 1997 that the government expected to earn US\$28 billion from the sale. Motta's death in April had raised concerns that the selloff might be delayed (see NotiSur, 05/01/98).

Market volatility affects TELEBRAS

Fallout from the Asian financial crises forced the government to lower its expectations regarding the TELEBRAS sale. Financial problems in major emerging markets such as Indonesia also cooled investor enthusiasm for many Latin American stocks, particularly large ones like TELEBRAS. Investors have taken more money out of Latin American equity mutual funds so far this year than they put in during all of 1997, according to figures provided by Caspian Securities. Earlier this year, some investors expected the division of TELEBRAS to raise the price of shares as much as 100%, but many of those same investors now doubt that will happen.

Some investors also say questions regarding the TELEBRAS split have convinced them to hold off on buying shares. "There's been a great deal of confusion about the privatization for shareholders," said Emily Alejos, Latin American portfolio manager at BEA Associates in New York. "If you own TELEBRAS today, what do you get after it's privatized? There's value there, but whether that value will be realized in two months is extremely difficult to say. There's a big disconnect between the fundamentals and the prices right now." On June 1, TELEBRAS stock traded at about US\$106 a share in New York, 9% below its price at the beginning of the year. Some analysts are confident the price will jump once investors see how much bidders are willing to pay in July. Brad Radulovacki, an analyst at Daiwa Securities in New York, expects the stock to go to about US\$170 a share at the time of the auction.

Base price may be close to final price

The government said it set the base price relatively low because it wants to create a highly competitive phone system, especially in the cellular business. But it expects some of the component companies, especially the cellular businesses, to draw much higher bids than their base prices. "The (overall) price was in line with market expectations," said Sergio Goldman, a telecommunications analyst at Santander Investment in Brazil. "With this price, we can expect an average premium of about 25%."

International phone companies are interested in TELEBRAS because of the tremendous demand for phone service in Brazil. Despite having Latin America's largest economy, Brazil has one of the lowest per capita rates of telephone access, with just 10 phones per 100 people. Also, Brazil's US\$800 billion GDP and government commitment to free-market reforms make it one of the most promising emerging markets.

But even with the Brazilian government allowing foreign companies to bid in the TELEBRAS auction without a domestic partner, some analysts doubt the government will reap earnings much above the base price. A study in late May by Merrill Lynch indicated a price of US\$14 billion is likely. Opposition candidate says president seeks slush fund from sale The low base price for TELEBRAS quickly became a political issue.

Partido dos Trabalhadores (PT) presidential candidate Luiz Inacio Lula da Silva accused Cardoso of accelerating the TELEBRAS sale to finance his campaign. "Possibly the government wants to create a slush fund for the electoral campaign," said Lula at the PT convention, implying that the government would sell TELEBRAS for less than its real worth and the buyers would then contribute heavily to his re-election campaign. "If this continues, we're going to be paying whoever gets TELEBRAS." Lula's running mate Leonel Brizola supported Lula. "Not long ago, the late Sergio Motta said the state's share of TELEBRAS was worth US\$40 billion," said Brizola. "The government reduced the price to US\$25 billion, then to US\$18 billion, and now it is only asking US\$11 billion. What's going on?"

Lula and Brizola proposed creating a commission to review the process that set the base price. The government dismissed Lula's charges and moved swiftly to reassure investors at home and abroad. Officials began efforts to discredit Lula with dire predictions of economic consequences if he wins. Senate leader Antonio Carlos Magalhaes said a Lula victory would bring "chaos," while Central Bank President Gustavo Franco predicted foreign investment would pour out of Brazil if Lula were elected. Cardoso sues for defamation Sergio Amaral, spokesperson for Cardoso, called Lula's charges "irresponsible and regrettable, since they have absolutely nothing to do with what is really happening." Amaral said the president could not just dismiss such statements as campaign rhetoric.

On June 12, Cardoso's personal lawyer asked Attorney General Geraldo Brindeiro to file two lawsuits against Lula for character defamation and violation of election laws. Under Brazilian law, Brindeiro has 10 days to decide whether to proceed with the lawsuit. If convicted of defamation,

Lula could be fined and sentenced to between six months and two years. If convicted of election-law violations, he could be barred from running in the election or, if already elected, forced to resign.

On June 11, Lula said if elected he will review the entire privatization process and impose a "quarantine" on foreign investments to stop the country from being flooded by speculative capital that jeopardizes the financial system. "We have no intention of nationalizing the economy again," said opposition Deputy Jose Genoio, "but we are going to examine what happened with the privatized businesses." On June 15, Brizola said the TELEBRAS privatization would be annulled if Lula is elected. "We are not going to recognize the validity of that operation," said Brizola. "I am warning the interested investors. The auction is going to be annulled by the next government."

The battle regarding TELEBRAS erupted less than four months before the election. Recent polls show Lula and Cardoso almost tied, following a sharp drop in support for Cardoso after criticism of his handling of this year's fires in the Amazon and the starvation in Brazil's drought-stricken northeast (see NotiSur, 04/24/98 and 05/15/98). The likelihood of a runoff is causing the administration serious concern and has both sides trying to capitalize on the TELEBRAS controversy. [Sources: The Miami Herald, 06/01/98; Reuters, 06/10/98, 06/13/98; Clarin (Argentina), 06/11/98, 06/13/98; Spanish news service EFE, 06/12/98, 06/13/98, 06/15/98; Inter Press Service, 06/15/98]

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