The Bank of Brazil from the Mid-1990s to 2005: An Analysis on the Basis of its Adaptation to the Basel Regulations

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1) Introduction

Due to its dual (or hybrid) nature, the Bank of Brazil (BB) faces the following dilemma: on the one hand, its operation results from injunctions established by the rationality of private business; on the other hand, it is the instrumental public dimension (as the agent that puts to practice the economic policy or public policies in general) that determines the purposes of such operation. The tension resulting from these two vectors imparts a particular behavior or course of action to the bank. It was precisely the combination of these two forces, sometimes complementary, sometimes contradictory, that defined its history and conditioned its present situation.

Since 1994, the bank went through a number of changes, which resulted in a certain operation profile. The purpose of this article is to analyze the history of the Bank of Brazil since the Real Plan (the plan that establishes the current national currency), up to the present time. Our working hypothesis is that there is, as from 2001, *reinforcement* of the private business dimension of the Bank of Brazil, which would make it possible to define its current operation not as that of a typical public bank, but rather as that of a state-owned bank. That is to say that the BB remains up to this day a hybrid entity, *but quite different from what it was until in the recent past.* The difference lies in the fact that, contrary to what prevailed in the past, the logics of its operation is currently defined predominantly in the same terms as a typical private bank, although the major shareholder of this financial institution remains the Brazilian State[1] and in spite of the persistence of programs and actions of a public nature.

In view of these purposes, it seems convenient and fruitful, from a conceptual point of view, to make a preliminary effort of delimitation that enables the characterization and the understanding of financial institutions with different functions, purposes and *modus operandi*.

2) Theoretical and institutional aspects – a proposal of conceptual delimitation for public banks

The purpose of this section is to attempt to establish a methodology that enables a more adequate understanding of the many agents, practices, structures and processes that determine the historical context and the operation dynamics of the BB. With a view to that, we propose as a point of departure a discussion of some concepts that will be useful in the course of the analysis: those of commercial bank, of public bank, and of federal bank.

The commercial bank and the management of risk

Traditionally, commercial banks worked as: 1) intermediaries of the financial resources of public banks; 2) generators of credit (and currency). However, as many changes in the financial system blurred a few of the classic divisions among financial institutions, if we take such institutions to be *risk managers*, we may be able to say that what sets commercial banks apart from other financial institutions is the *nature* of the risk they manage. As a general risk manager, a bank with a commercial portfolio is less and less distinguishes from an investment bank, from a financial company or from a credit cooperative. Its specificity lays in the unique character of its liabilities, which is distinguished by the existence of "debts in sight", and by the need thereby created to define a hedging strategy that emphasizes the availability of reserves or easy access to them. Thus, to possess reserves in currency or assets of high liquidity, in spite of its low profit – or even its lack of profit – is an intrinsic feature of the hedging strategies of these banks. The deep concern with liquidity is inherent to the nature of a commercial bank.

According to this approach, banks are *active* agents that manage dynamically both components of their balance sheet. In other words, the bank does not take their liabilities for granted, inasmuch as it attempts to influence the preferences of its depositors by means of a dynamic management of obligations and by ever introducing financial innovations. The notion of *active rivalry* is fundamental to characterize its operation – it is precisely through competition that innovation is triggered and the resulting structural change takes place. As Minsky suggested:

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[1] BB's major shareholder is the National Treasury, with 72,1% of the total capital, followed by the PREVI – 13,9% - and by the BNDESPAR - 5,7% (December 2005). 6,9 % of the shares are pulverized on the market (the so-called *free float*), and the rest (1,4%) is in the treasury of the bank.
From the shares on the market, 49,7% are owned by foreign capital. The participation of foreigners in the bank's capital is limited to a maximum 5,6% (as a result of a legal determination).

A banker is always trying to find new ways to lend, new customers, and new ways of acquiring funds, that is, to borrow; in other words, he is under pressure to innovate (Minsky, 1986, p. 237).

Banks and bankers are not passive managers of money to lend or to invest; they are in business to maximize profits. They actively solicit borrowing customers, undertake financing commitments, build connections with business and other bankers, and seek out funds. Their profits result from charging for funds they make available, even as they pay for funds. Banks, in effect, lever their equity base with other people's money, and profits are derived from fees for accepting debts, committing funds, and miscellaneous services – as well as the spread between the interest rates they charge and they pay (Minsky, 1986, pp. 229-230).

The development of new financial instruments and of techniques associated to liability management is particularly important to the evolution of the banking system. Liability management refers to the capacity of banks to alter interest rates in order to raise funds (in retail or wholesale) that may be employed to finance its lending activity. In other words, banks do not wait passively for the availability of new deposits (resources) through the purchase of papers by the central bank, nor do they grant new loans solely with the income resulting from the sale of other assets. On the contrary, they introduce financial innovation which allow to increase the elasticity of credit supply in relation to the regulations that aim at limiting such ability of response.

However, although innovations have expanded the banks' capacity to supply credit whenever there is a demand for it, such a strategy of liability management has also increased banks' exposure to liquidity risk when they supply credit: the increase in the balance sheets results from potentially volatile sources, associated to new and relatively insolvent loans grated to productive activities. Thus, the decision-making process on the part of the bank is inexorably intertwined with these liquidity matters.

Throughout the economic cycle, and independently of changes in the basic interest rates, the bank reassess its evaluations of the creditworthiness of the borrower and of the appropriate rates in the decision-making process; it therefore makes decisions that involve prices and quantities (Hewitson, 2003, p. 23). Thus, the credit supply is subject to being displaced as the perception of banks oscillate between more pessimistic and more optimistic positions, which affects their standards of liquidity, which will increase or diminish in accordance with such reversals of expectations (which may even be more abrupt, for example in more turbulent periods).

In phases of expansion of the economic cycle, in which an environment of growing optimism is created or consolidated, granting credit, on the part of the banks, becomes almost limitless, which inevitably leads them to finance positions of ever more fragile debts, positions in which there is a fundamental "mismatch" of assets and liabilities, either regarding the deadlines, or concerning other "indexes" (Minsky, 1986, cap. 9). This entails a situation in which, as time goes by, an economy's growth on the basis of a robust financial structure generates a structure that gets more and more fragile. Financial cycles are essentially endogenous. Depending on the trajectory of economy and on how economic authorities react (for example, whether or not they implement expansionist tax and currency policies or whether or not they decide to revert the expansionist cycle), a growing degree of financial weakness may bring about a financial and economic crisis (instability).

In other words, in a capitalist economy, banking, although fundamental, is a source of destabilization. [Paraphrasing Kalecki, who formulated a similar phrase in another context, the tragedy of banks is that they are useful.] As Minsky states:

> In order to understand our economy it is necessary to take a critical, no-nonsense look at banking. It is a disruptive force that tends to induce and amplify instability even as it is an essential factor if investment and economic growth are to be financed (Minsky, 1986, p. 229).

Bearing such considerations in mind, we propose in the sequence a tentative taxonomy that may be able to define, always at a conceptual level – although taking other institutional dimensions into account – different kinds of banks.

The concept of public bank

A public bank is an institution whose shares are controlled by the State and that mainly performs one or more of the following activities, many of which are interrelated: i) provide long-term stimulation and credit to segments that are politically regarded as priorities and that are not catered for by private banks, an action which is generally based on special funding, whose resources are derived from sources other than the market; ii) define new goods and/or new costs and deadlines for already existing goods, as a means of inducing the market to operate on new bases – i.e., promoting a financing policy in the broader sense of the expression; iii) regulate the market in a broader sense, as a privileged *locus* for the implementation of monetary and credit policies; iv) act on the market of credit in the sense of minimizing uncertainty when it is too high, a situation in which credit has been limited by the private sector.

Financial institutions were created by the State to provide the modalities of credit that private financial institutions are not interested in providing. One reason why private financial institutions do not supply a specific category of financial service or make a loan is evident: the expected default rates are high – and at a sufficiently high interest rate to cover such defaults, the market may simply become inoperative. Thus, one of the purposes of the operations of a public bank is to cater for those markets which the private sector is unwilling to provide for.

A public bank, regarded as a development bank, is that financial institution which, because it is a recipient of fiscal or para-fiscal resources at a lower cost than those originating from the market, may provide long-term funding and credit lines, catering for segments and sectors different from those voluntarily and willingly sought by private financial agents. The priorities of the credit supply are thus an important feature of a public bank's operations. In this modality, which is typical of a public bank, i.e., being a development bank, the institution is tied to a particular line of economic or public policy in general, explicitly aiming at promoting social and economic development through the choice of specific sectorial and/or social policies.

In this *instrumental* dimension, not only as a stimulation bank, but also as an inducer of new actions on the market, the public bank is the privileged financial agent that executes governmental policies. In this dimension, the concern with social results, which are difficult to measure, overrides the concern with gain (individual and private or institutional and public) derived from investments that the institution may finance. As a matter of fact, a good performance of the bank as a stimulation bank and as an inducer of new paths on the market may be, and often has to be, in contradiction with the financial performance of the bank itself.

It is also worthwhile to draw attention to the public banks' role as agents that are fundamental in executing monetary and credit policies defined by the economic authority. It should be said that a public bank can and must, by exerting its power on the credit market, force the market to more rapidly follow the directions of monetary and (possibly) credit policies, whatever they may be, thus contributing to their greater efficacy. In this sense, its public dimension, as a market regulator, also tends to be in opposition to the private dimension of maximizing profits.[2]

Another important aspect in this discussion relates to the nature of capitalist prospective calculations, characterized by the formulation of expectations in an environment of genuine or fundamental uncertainty, which tends to generate phases of greater or lesser instability within the economic system. Under such conditions, the regulating action of a public bank (in the framework of an economic policy that purports to define strategic objectives) would have as its role to bypass, or minimize, the uncertainty that inexorably affects economic processes, Its purpose should be 'to defeat the dark forces of time and ignorance which envelop our future' (Keynes, 1936, p. 155). In situations in which private banks are less willing to deal with uncertainty, public banks would tend to minimize or gradually diminish it by acting on areas in which the private sector, for different reasons, would not act (and under special conditions of private credit supply), if they were to act solely according to their typical logics.[3]

The concept of state-owned bank

We here propose the creation of an analytical category that should enable to make a strategic distinction. Thus, a state-owned bank could be defined as a hybrid financial institution, in which the prevailing operation logic is that which is characteristic of a private bank, but whose major shareholder is the State. The search for and the fulfillment of aims defined by public policies, when they do take place, remain secondary and subordinate to a private managerial perspective.

In this case, the main operation focus privileges aims, objectives and purposes associated to the typical rationale of private business: maximized profit, operational efficiency, optimization of incomes, return to shareholders, etc.

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[2] It is also worthwhile to point out here other more localized market regulating actions that public banks may perform – and which they actually did perform many times, for example carrying at large quantities bonds that tend to be rejected by the market at moments of greater uncertainty (which is true even for the case of public debt), thus contributing exemplarily to the general stability of the system.

[3] An action of the public bank in the contrary sense would be also suitable here, that is to say, not following the market at times of intense optimism, in an attempt to set back the establishment of excessively fragile financial structures, generated, according to Minsky, endogenously, by the market.

It should also be emphasized that this line of action is no the result of a process of gradual dissociation or emancipation from governmental direction, but rather of a new approach, generated within the process of formulating governmental policies, which starts to promote the new standard of operation for the financial institution and banks on the cooperation of the structures of the institution. The concern with "private" returns superposes itself to the care for governmental policies focused on social returns, and even to regulatory and financial policies.

3) The 1986-1994 period – institutional reforms, conglomeration and financial weakening

The purpose of this section is to summarize briefly the main events and processes of BB's history between 1986 and 1994, which ended up unfolding some of the transformations in the period following the *Plano Real*. These years are distinguished by the revision of the funding model of the BB, as well as of its role within the national financial system (see Vidotto, 2002, chap. 10, and Jung, 2004, p. 99-115).

In the mid-1980s, the process of restructuring Brazilian public finances is accelerated. The major claim was the need to unify and render transparent the budgeting process. The purpose of budget unification was to mitigate the confusion entailed by the existence of many different budgets and, as a result, to control more effectively public expenses. Among the many measures that were taken, that which caused the greatest impact on the BB was the freezing of the balances and the later extinction of the so-called "movement-account". By this action, the BB suffered the fatal blow on its condition of monetary authority.

The new state of affairs deeply affected the bank. In other words, this institution was forced to look for new means of funding to cover its assets. In such an institutional context, the mechanism of the movement-account was replaced by systematic transfers of resources from the Treasury (which later proved to be a mistake) and by raising resources on the market. It is in this sense that, after 1986, the accounts of the bank were marked by a fatal inconsistency: the *asset operations* were under strong influence of the economic policy, and the *liability operations* were growingly determined by the conditions of the market.

Thus, the origins of this process can be summarized according to two features (according to Vidotto, 2002, p. 285-286):

1) Impacts of the institutional reforms of 1986/1988 on its funding:

- end of the movement-account
- withdrawal of the sight deposits by many governmental instances;
- decrease of the transfers from the National Treasury;
- the adoption of a mainly borrowing positions with relation to other banks;
- the rural savings account, a relatively expensive source of funds, becomes important.

2) Asset operations

- refinancing and extending deadlines (mainly favoring rural producers) of debts that deteriorated the financial conditions of the bank

3) Outcome:

- growing dissociation of deadlines and costs between procurement and allotments of funds.

With the promulgation of the Federal Constitution of 1988, another major change took place. The management of governmental funds and programs was transferred from the Central Bank to the National Treasury, entailing the withdrawal of the BB from its role as cashier of the Treasury, which further complicated access to non-remunerated resources. Vidotto (1995, p. 62) assesses that the actual loss of resources stemming from this measure was roughly equivalent to that brought about by the extinction of the movement-account (about US$ 7 billion)

As a result of the decrease in the resources that traditionally supported its operations as a development bank as well as of the need to respond to the process of financial weakening, the BB implemented a process of conglomeration (see Jung, 2004, p. 107ff). Such a process was put to practice through the creation of many subsidiaries of the commercial bank, which acted on different segments of the financial market, such as the *BB Distribuidora de Títulos e Valores Mobiliários S. A.*, the *BB Financeira S. A, the BB Corretora de Seguros e Administradora de Bens S. A.*, the *BB Administradora de Cartões de Crédito*, and the *BB Banco de Investimentos S. A.*

The conglomeration was an attempt to respond to and avoid the crisis in which the institution was immersed, reflected on the typical dimensions of its dual nature, i.e., on its role as an instrument of economic policy (more specifically as a governmental credit agent), as well as regarding it more explicit insertion in the competition against other banks, with the aggravating circumstance that it had to deal with a progressive patrimonial and financial deterioration. With hindsight, it is possible to establish that the conglomeration process was the first step of the institution towards the adoption of a rationale typical of a private bank,[4] which meant the beginning of the apprenticeship of the necessary skills and resources to thoroughly implement an effective process of conglomeration, which would only be consolidated further on in the 1990s. This period may be characterized as that in which the bank cuts its way through a dense and still unknown forest.

Thus, from the mid-1980s to the mid-1990s, there is a progressive fall in the tax-originated resources in the funding of the BB, similarly to what happened to other inexpensive or little expensive liabilities. On the other hand, which is paradoxical, it is typical of the period that the institution was summoned to try to solve the fiscal and financial crisis of the Brazilian State and to "socialize the losses". As stated by Jung (2004, p. 115-116), "the Bank of Brazil kept being called upon by the government and by society at large to perform mainly public duties, which were contrary to private rationality". This period is also characterized by the strong political interference of corporate interests (mostly lobbies of rural producers), which resulted in the financial protection of certain segments.

This is the period in which the bank comes to a crisis and starts trying out alternatives. The history of the establishment of the BB conglomerate is therefore characterized by the specificities of a financial institution whose field of action was being defined within a larger process of revising the role of the State in the economic sphere:

[4] At least in the most recent period, which is the object of this analysis.

the purpose of imparting an eminently private character to its management and to the whole process of expansion and diversification of a Federal financial company ends up facing structural limits that refer to the preeminence of its role as a publicly owned company. In other words, the same sort of conditioning factors that triggered the constitution of the conglomerate is also responsible for the vicissitudes of the conglomerate itself (Vidotto, 2002, p. 285).

In the following section, we examine the main events immediately following the *Plano Real*, up to the introduction of the Program for the Strengthening of Federal Financial Institutions, in June 2001. The latter represented a major inflexion in the history of the Bank of Brazil, which will be duly considered later in this paper.

4) The 1995-2001 period – crisis and capitalization: in search of a new identity

From the point of view of the reorientation of public banks, and of the Bank of Brazil in particular, a few measures taken by the Federal Government between 1993 and 1995 are crucial (Jung, 2004). They are:

1) the creation of a Committee for the Managerial Coordination of Public Financial Institutions (*Comitê de Coordenação Gerencial das Instituições Financeiras Públicas*, COMIF), in 1993, within the Ministry of the Treasury, a measure that would express the perception, on the part of the government, of the need of coordination and centralization of the policies of the Federal Public Financial Institutions (*Instituições Financeiras Públicas Federais*, IFPFs)
2) the Short-Term Plan, in 1994, which emphasized the importance of the public financial system and the need to adapt it in order to discipline governmental expenses;
3) the Immediate Action Plan (*Plano de Ação Imediata*, *PAI*), in 1995, which, regarding public banks, made explicit the need to make them solvent and to more clearly define their role;
4) the Technical Notice 020/1995, by the Ministry of the Treasury.

The Technical Notice 020, in particular, from 1995, was a document of great importance for the future of federal banks, since it established the governmental policy for these institutions, even though the implementation of its directives was neither complete nor linear (Vidotto, 2002, and Jung, 2004). Its purpose was, briefly stated, to set up the missions, strategies, aims, adaptation parameters, and lines of action of these institutions:

> the financing agencies of the federal government, in the present context and in the foreseeable future, are justified as instruments for the implementation of its credit policy and as agents of the National Treasury, as a complement to the financial system, for reasons of strategic security (Ministry of the Treasury, 1995, apud: Vidotto, 2002, p. 215).

Concerning more specifically the Bank of Brazil, the document states that it was to maintain the following features:

> A federal financial conglomerate, specifically aiming at agricultural and industrial, and foreign trade funding, at relating to the international financial market, and at acting as the main financial agent of the National Treasury (Ministry of the Treasury, 1995, apud: Vidotto, 2002, p. 217).

As regards this point, an important matter arising concerns the reaffirmed maintenance, in an apparently adverse context, of the federal public sector as a direct participant and such an expressive one in the national financial system and, even more so, due to how this maintenance was reaffirmed. If, on the one hand, it is true that the Federal Public Financial Institutions, differently from the state banks (*bancos estaduais*), are not privatized and, at the level of the discourse, are reaffirmed as being necessary, on the other hand, one can also remark, among these changes of which the Technical Notice is one of the earliest expressions, a movement of federal banks, and of BB in particular, towards the typical logics of a private bank, to the detriment of its former public rationale. In this sense, the BB would appear to be progressively abandoning its condition of a public bank and assuming that of a Federal bank (as previously defined). It is as though, in spite of its remaining Federal property, the effective space for implementing public policies gradually reduced, increasing, on the other hand, the microeconomic importance of the company and its capacity to generate profit for the shareholder.[5] The ensuing adaptation of the bank to Basel I regulations, and its future adaptation to Basel II regulations, are milestones of this very same trajectory, which becomes clearer as from 1995.

Another event of the utmost importance in 1995 for the future history of the Bank of Brazil, as can be gleaned from Table 1, was its expressive loss (R$ 11,97 billion), fundamentally due to the negative results of its operations as a financial intermediary (R$ 650 million), i.e., to the high degree of insolvency of its loan portfolio.[6] In this context, the bank launched corrective measures (the Adjustment Program), in order to cut down on the expenses and increase the income. The results were nevertheless insufficient to solve, in the short term, the institution's problems, given the level they had reached. Furthermore, conjunctural variables, such as the rise of insolvency and the valuation of the *real* to the dollar, counterbalanced the efforts of the adjustment.

In 1996, the loss was even bigger (R$ 19,07 billion), also basically due to the negative performance of the loan portfolio (R$ 6,47 billion).[7] Such a performance could be largely explained by the conservative policy of credit provisioning and by the "harshening" of the bank's negotiations with its debtors, especially in the agricultural area (Jung, 2004; Vidotto, 2002).

Given that the net assets of the bank by the end of 1995 amounted to R$ 9,76 billion and that the outcome in 1996 was a loss of R$ 19,07, the bank would have gone bankrupt in that year if it had not been capitalized. The capitalization occurred and had the following composition: new shares were printed, at the value of R$ 8 billion, R$ 6,4 billion of which

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[5] Regarding this point, Vidotto (2002) states that the movement of adaptation of public banks to a private rationale, including as regards the central issue of credit management, represented a 'counterpart in the form of the adaptation of the institutions to the structural circumstances of their reformulation; thus, the fundamental problem of their action does not specifically refer to these criteria, but rather to the political guidelines to which their are subordinated' (Vidotto, 2002, p. 248)

[6] Actually, because of the drop of inflation rates, in the second term of 1994, the Bank already accumulated losses.

[7] See Table 1, with data from December 2005 deflated by the IGP-DI.

were bought by the National Treasury, R$ 500 million by the BNDES-Par, and the rest (R$ 1,1 billion) by the Pension Fund of the Employees of the Bank of Brazil (*Fundo de Previdência dos Funcionários do Banco do Brasil*, PREVI).[8] The capitalization, at the magnitude it was done, squared the problems of the institution. At the same time, a mass of credit that could be recovered in the future was made available to the bank.

It is still important to emphasize that the capitalization also adapted the net assets of the bank to the demands of the Basel Accord, adopted in Brazil in 1994, which established a minimum ratio of 8% between the institution's capital and the risk-weighed assets.[9] As Table 2 shows, in 1995, the "Basel Index" of the bank was 5,7% (i.e., below the required) and, at the end of 1996, after capitalization took place, it reached 11,1%.

In the years that followed (1997 to 2000), the bank managed to make profit. The most conspicuous difference as compared to the two preceding years (1995 and 1996), as can be gleaned from Table 1, lies in the result of financial intermediation (the result of credit operations), which becomes positive, at the same time that a slightly decreasing trend can be noticed concerning expenses with personnel, a result of the Adjustment Program, of which the Program of Voluntary Detachment (*Programa de Desligamento Voluntário*) was a key component.

The issue of credit is, as has been seen, central in this discussion and deserves to be emphasized. In this context of reforms and reorganization, beyond owning up to the "errors" of the past, which were responsible for the many problems then being dealt with, it was thought that the bank was not sufficiently qualified to supply credit in a context of economic stability. The need of new practices in this area was felt and in order to produce them, the following measures were established: the adoption of a limit of credit per client, the dissociation of credit and operational functions, and the decision on granting credit became exclusively collegiate. Credit grants adopted as reference an assessment of the sectors according to their business interest to the bank. Such an assessment suffers periodical revisions with a view to reflecting the analysis of specialized areas of the bank, in order to revise the policy of credit and, more precisely, the risks and limits of credit exposure per client. As Jung states:

> The set of measures signaled to the creation of a 'credit culture', breaking away from the so far prevailing criteria of catering for the demands for the funding of sectors or companies that faced difficulties of access to credit on the market – in this sense, taking up the role of a borrower of penultimate instance.
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> One actually moved towards the creation of a 'credit culture' very similar to the one adopted by private banks, which gave preponderance to the valuation

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[8] 'The renegotiation of these credits would prove to be of fundamental importance in the following administrations. While longer-term and broader reforms were being implemented, it was the recovery of insolvent credits, enabled by the negotiation instruments made available by the government that ensured the bank's positive results. These instruments were the securitization of the operations, as from 1996, and the introduction of the Special Program for the Adjustment of Assets, in 1998. The measures had in common the extension of the deadline of the debts and the substitution of the original credit instruments with future governmental bonds. The debtor, alongside with the purchase of such bonds, agreed to become responsible for paying the interest rates on these bonds" (Jung, 2004, p. 128).

[9] Brazil's adoption of the Basel I rules was effected through Decision 2099 of the Central Bank, dating from November, 17th, 1994, where the 8% ratio was defined. In June 1997, the level of capital was raised to 10% of risk-weighed assets (Decision 2399); November the same year, the level was raised to 11% (Notice 2784).

> of the risk-weighed capital as a criterion to determine the general conditions for granting credit and the performance of other services for clients (Jung, 2004, p. 130-131).

Vidotto (2002) further notes that, in the absence of guidance arising from a policy coordinating the activity of public banks, the bank itself set up its rules of conduct, which were to bring it closer to the line of action of a typical private financial institution.

This change in the ‘credit culture’ in the Bank of Brazil as from that period is emphasized in the literature, being regarded as one of the most relevant issues in the bank’s recent history (Vidotto, 2002, p. 280; Oliveira, 2003, p. 47-49; Jung, 2004, p. 130-131). The positive results of the following years, which show a reversal of the 1995-1996 losses (see Table 1, especially the data concerning profit and the results of financial intermediation), seem to corroborate the thesis that credit management became more efficient after these guidelines were altered.

Nevertheless, from our viewpoint, a crucial matter is to assess whether, beyond BB’s results seen as an ‘amount of capital that seeks its own valuation’ and/or a ‘source of generation of primary surplus for its controller’ (Oliveira, 2003, p. 45), the bank remains as a central institution for the implementation of public policies. In other words, considering the analytical categories proposed at the outset of this paper, did the Bank of Brazil, which was not only privatized, but also capitalized, get stronger as a public bank or did it begin its trajectory as a Federal bank, properly strengthened?

Oliveira (2003), attentive to the issue of rural credit, makes a harsh assessment in this regard:[10]

> As from 1995, the management of the agricultural credit portfolio is submitted to the rigors of financial globalization, by means of fiscal adjustment and the principles of prudential regulation dictated by the Basel Accord. The search for a minimum profitability in rural credit becomes fundamental for the survival of the Bank of Brazil. ...
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> Rural credit in the 1990s is conditioned to two major forces, which contribute to the preservation and reproduction of capitals that interact in the agribusiness: (1) the one reflects the decision-making power of the Agricultural and Industrial Complexes regarding the formulation of the agricultural policy, in the face of the crisis of the State, and (2) the other seeks the standardization of prudential bank regulation with a view to preserving the stability of financial systems, both national and international.
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> At the convergence of the new dynamics of Brazilian agriculture and the financial globalization, a milestone in the history of Brazilian rural credit is established in 1995. This milestone is reinforced by BB’s strategy to become more modern and competitive (Oliveira, 2003, p. 13-14).

Oliveira (2003, p. 47) further states that performing safer and more lucrative credit operations – i.e., acting as a typical commercial bank – has a social cost that cannot be

[10] Oliveira’s analysis is limited to the 1995-2001 period.

overseen (although it has been little noticed). Specifically regarding the issue of rural credit, this new strategy *aggravates the exclusion of small producers and reinforces the large groups that operate in the agribusiness.* Thus, in the course of the 1990s, as it was refashioned to operate as a Federal bank, the Bank of Brazil may have somehow contributed to a distributive worsening in the agricultural sector.[11]

Vidotto also makes important considerations regarding the redefinition of the bank's role. The author does not, however, consistently determine this new role:

> It is also necessary to identify the change in the contents of these two subsystems [of official credit: rural credit, concerning which about two thirds were provided by the BB, and that of housing loans, mainly catered for by the CEF]. The new state of affairs imposed its limitation as a policy instrument in two senses. First, the reduction of its role as an instrument of socializing the losses in the form of a 'hospital' for companies or sectors whose recuperation does not present sustainable economic possibilities. Industry and agriculture provide many examples in which public banks abandoned companies or a whole sector, as well as others in which coverage was reestablished after a process of 'savage' selection. This means to say that these instruments actually became, in certain lines of business, more selective and less bound to the previous productive structure. On the other hand, new lines and programs have been structured, which move in the opposite sense of that movement (Vidotto, 2002, p. 254).

The new lines and programs to which the author seems to make reference in the above paragraph are created, according to himself, 'externally' to this reorientation of the policies and practices of credit granting. On the one hand, this would include constant renegotiation of the debts of the rural sector, which were time and again 'ripped away' by the 'ruralist lobby', to such an extent that, far from being the exception, this practice would rather represent the logics of the relation between the bank and this sector. On the other hand, the author, points to the creation of the Program for the Strengthening of Family Agriculture (*Programa de Fortalecimento da Agricultura Familiar*, Pronaf), in 1995, 'whose relevance stems as much from the values involved as from its purpose of funding rural producers of low income' (Vidotto, 2002, p. 281).

Summing up his argument for this issue, Vidotto (2002) states that, despite the changes underwent by the Bank of Brazil in the 1990s, it remains as the major agent of the rural credit policy, offering special conditions for accumulation in this segment.

Another index that deserves to be assessed for the purposes of such a discussion is the evolution of the bank's participation in the total credit supply in Brazil for the period being analyzed. BB's participation in the total credit operations in the banking system was, in 1994, 19,9% (Table 9 and Chart 2). This participation dropped to 16% in 1995, as a result of having changed the management of problematic credit, which entailed the provisioning of defaulted credits. In 1996, the participation drops even more, reaching 10,6%, for the same reason. Credit operations in the balance sheets of the bank in these two years amount respectively to R$ 95,37 bi and R$ 65,23 bi, which represents a significant contraction of the loan portfolio, as can be gleaned from Tables 1 and 3 and, more clearly, from Chart 1.

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In spite of a mild recovery in 1998 – the percentage of the bank's participation in the total credit operations rise to 12,1%, as a result of the increase in the volume of credit operations on its balance sheet, from R$ 61 in 1997 to R$ 63,6 bi in 1998 – the Bank of Brazil does not recover its former position before the end of the decade, and in the year 2000 its participation in the total credit operations comes to 11%, as can be seen in Table 8 and in Chart 2.

Still in the period under discussion, a relevant issue is to determine once again the bank's situation regarding the Basel Index. In 1997, the Central Bank of Brazil increased the capital requirements of banks operating in the national financial system to 11%, i.e., above the 8% recommended by the Basel Committee, and which the Central Bank itself demanded of banks between 1994 and 1996. Given the new capital requirements, the Bank of Brazil was insufficiently provisioned in 1997 (10,8%), on the limit in 1998 (11,1%) and again below the target in 1999 (9,2%), as can be seen in Table 2. It is within this context, especially in the case of the Bank of Brazil, that we may understand the contents of the Program for the Strengthening of Federal Financial Institutions (Provisional Measure 2196, 06/28/01) and the major transformations taking place thereafter.

Bearing in mind the issues so far dealt with, a possible general conclusion concerning the ('seemingly private orientation' of the) management of the BB in the second half of the 1990s is the following:

> It is necessary to distinguish in the three traits analyzed for the second half of the 1990s – evolution of the asset structure, evolution of credit and performance criteria – the guidelines of the economic policy that underlie the seemingly private orientation of the management of the BB. For the restoration of the assets this trait is patent. Regarding the reorientation of credit policies, which consisted in driving away from activities of little profitability performed with market funding, it must be emphasized that it took place in the absence of an industrial policy. Even concerning the administrative adjustment, in which such an orientation found room for deeper implementation, one must point out that it remained ambiguous in character, inasmuch as its eventual success contributes to reinforce the instrumental reach of the institution (Vidotto, 2002, p. 292).

The purpose of imparting a predominantly private character to the management of this institution, in the first presidency of Fernando Henrique Cardoso, ended up being limited by structural constraints, reinforced by momentary internal and external instability. In other words, the same sort of conditioning factors that triggered the constitution of the conglomerate is also responsible for the vicissitudes of the conglomerate itself. The purpose of implementing a reorganization that was to prepare the bank for privatization collided against default and losses, the attempt to increase private participation failed and the effort to privatize one of the most important companies in the conglomerate was reversed.

Against this background, the bank's capitalization of R$ 8 bi, in 1996, can be better understood. It represents the apex of successive moves that accompanied the end of largely subsidized credit for agriculture after the extinction of the movement-account in 1986, a period when the protection of agriculture by the State through credit did not disappear, but was increasingly hidden by the deterioration of the BB's accounts. Once the crisis had been tackled by means of the equity restructuring of the Federal bank, it is as though capitalization came to perform *a posteriori* the role of the movement-account, with the difference that, even though the fiscal nature of these resources is much more explicit, the determination of the financial conditions and of the amounts involved remained subject to uncertain and precarious procedures (Vidotto, 2002, p. 300).

The rationale of operation that was created and consolidated in the following period helps to shed light on these issues.

5) The 2001-2005 period – corporate governance under the Basel Accord: predominance of a private rationality?

The Program for the Strengthening of Federal Financial Institutions (Provisional Measure 2196, 06/28/01) attempted to adapt the banks controlled by the federal government to a kind of bank regulation similar to that of private banks. The Program avowed that the purpose of the new legislation was to reflect 'international standards defined by the Basel Accord'. This legislation would make banks 'stronger, more competitive and, above all, more transparent'. It claimed that it was necessary to impose on the Federal Public Financial Institutions (*Instituições Financeiras Públicas Federais*, IFPFs) 'the same discipline imposed on private banks'.

The emphasis on the private rationale was put on the same level as the alleged 'institutional mission' of each institution:

> The point is to make sure that the federal public institutions are ready both to compete as commercial banks and to perform effectively their mission of promoting economic and social development, given that their privatization during this term of office is a hypothesis definitely put aside, as President Fernando Henrique Cardoso has already publicly declared (Ministry of the Treasury, 2001).

From the viewpoint of the Bank of Brazil, the Program for the Strengthening of Federal Financial Institutions represents the continuity of corrective and capitalization measures undertaken in 1995 and 1996. These measures had as purposes:

> the adaptation of the Bank of Brazil to the Basel index and to the demands established by the organs that supervise and regulate bank and financial operations, thus strengthening the bank's capital structure.
>
> The adjustments became necessary due to the refinement of prudential regulation of financial institutions that entailed, among other measures, the increase in the minimum index of capital adequacy (from 8% to 11%), the increase in the risk-weighing percentage on tax credits (from 20% to 300%), and the set up, by a Central Bank Resolution (# 2682, in 1999), of new criteria for credit risk assessment and of new provisioning requirements (Ministry of the Treasury, 2001).

The main measures seek to transfer credit risks to the National Treasury and to exchange assets of low liquidity and low returns for liquid assets remunerated at market rates. In the particular case of the Bank of Brazil, this Program enabled:

- a reduction of R$ 6,98 bi in the risk-weighed assets;

- a reduction of R$ 768 mi in the Required Net Equity (*Patrimônio Líquido Exigido*, PLE)
- an increase of R$ 2,81 bi in the Reference Equity (*Patrimônio de Referência*, PR)

The implementation of this Program brought about a fundamental consequence: the Basel index, which in 2000 amounted to 8,8%, reached 12,7% in 2001; after that, it kept raising, reaching 15,2% in 2004 and 17,1% in 2005 (Table 2).

How do the analysts see this set of measures? To Vidotto (2002), its main significance lies not in its declared purpose (ensure the good governance of public banks), but rather in its being a vast program under which the State takes over the losses that had been socialized through the federal banks in the previous governments... thus closing a cycle without an official effort of identifying the beneficiaries or a deeper debate about its distributive impacts (Vidotto, 2002, p. 265).

However, and without overseeing this matter, *our hypothesis is that the main significance of the Program lies in the fact that, by strengthening the bank's capital structure, it intensifies the trend already noticed of conforming the BB to a private rationale, to the detriment of its public action*. Such a reorientation was conducted under the apparently indisputable pretext of conforming this institution – as well as the other national Federal Public Financial Institutions – to a set of internationally accepted rules, which, being in principle irrefutable, would aim at a bank's better risk management. By doing so, this set of rules would lead the banking system to a level of improved security. The analysis of a few recent data may contribute to confirm our hypothesis.

Table 3 displays the main accounts of BB's balance sheet for the 1995-2001 span. It shows that, after 2001, there was a clear increase in the volume of the bank's credit operations, as can been seen in Graph 1. Furthermore, it can be noticed that the growth took place above all in the segment of credit for the private sector, once the volume of credit for the public sector tend to decrease. The same table shows that the securities portfolio registered a 'leap,' in absolute figures, between 2000 and 2001, as a result of the measures determined by the Provisional Measure 2196.[12] In 2002, it remains at a high level (even though there is a decrease as a percentage of the total assets, as can be gleaned from Table 5).

Table 4 shows, for this time span (2001-2005), a tendency of increase in the revenues of financial intermediation derived from credit operations, as well as much instability in the securities operations, alongside with the general instability in the volume of the portfolio. Such a trend becomes clearer by examining Table 7, which shows the evolution of revenues from credit and securities operations in relation to the total revenues through this period of time. The revenues from credit operations tend to increase between 2002 and 2005. The revenues from securities operations, however, are relatively stable from 2002 to 2005, reaching a peak in 2003.

Table 8, in its turn, shows that the bank regains, in 2003, the participation that it had in the total credit operations of Brazilian banks in 1994 (i.e., before the adjustment of 1995-96). It then controlled 19,9% of the credit operations of the banking system and, after recovering

[12] The same 'leap' occurred in the amount of the total assets, which increased largely due to the injection of public bonds into BB's portfolio, with the result that, in 2001, securities represented 24,4% of the total assets, and, in 2005, they amounted to 25,9%.

from the setbacks of the 1990s, it controlled 20,4% of such operations in 2003 (Graph 2). The growth was particularly remarkable between 2001 and 2003.

Another importance evidence that should be considered for assessing the (new?) profile of the bank is the changes in the Basel index. Table 2 shows that, as from 2001, the BB conforms to the demands of capitalization that the Central bank imposed on the national financial system, having met, from this point of view, the purposes of Provisional Measure 2196. The same Table 2 presents the evolution of BB's profitability and productivity indexes. It basically registers a surge of profitability in the period under examination (from 12,9% in 2001 to 23% in 2004), as well as a tendency to improve the efficiency index (the ratio administrative expenses/operational revenues moves from 69,2% in 2001 to 58,2% in 2004).

Clearly, none of these indexes fully correspond to the main inquiry, i.e., to determine whether the recent measures, and, more specifically, the latest movement towards conforming the bank – as well as the other Federal Public Financial Institutions – to the rules of the Basel Accord merely 'reinforces' (financially) the Bank of Brazil or whether, to the contrary, it drives it away from its former role as a public bank, especially as a development bank. Nevertheless, the indexes available so far, including the positive results of the last years as expressed in the financial statements summarized in Tables 3 and 4, point to the conclusion that *the Bank of Brazil has been setting its guidelines with the purpose of attaining the best possible financial returns, a 'goal function' that seems to us to be in contradiction to the guidelines of a public bank, in the previously discussed terms.*

Therefore, and even though the analysis has been conducted through a relatively short period of time and based on relatively scarce data (both quantitatively and qualitatively), the present discussion was able to provide a few elements in favor of the conclusion that *there was a crucial change in the rationale of the bank, which strongly affected its performance*. In this sense, it is possible to state that the Program for the Strengthening of Federal Financial Institutions and the progressive conformation of the Bank of Brazil to the Basel regulations meant a crucial shift in the history of the bank. It represents, alongside with other equally important events that defined a specific trajectory for the institution (such as the extinction of the movement-account, which stroke the fatal blow on its performance as a monetary authority), a 'crucial event' in Shackle's terms, in the sense that it contributed to break away from previous practices and to change irreversibly the defining conditions of its previous context of operation.

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