

The BNDES as an Instrument of Long Run Economic Policy in Brazil

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1. Introduction

The Brazilian Economic Development Bank (*Banco Nacional de Desenvolvimento Econômico e Social* – BNDES) was created in 1952 during the second President Getulio Vargas government (1951–1954). As a state-owned financial institution, its initial objective was to foster the transition from a rural-based Brazilian economy towards industrial growth by supporting long term investments, outfitting capital to new upcoming activities and programs. Six decades later, the Bank is responsible for more than 70 percent of long term credit in the country. In terms of total assets, it is the third largest national development bank in the world, after the China’s and Germany’s. Compared with international organizations, its size is similar to the World Bank and about three times greater than the Inter-American Development Bank. If measured by the standard indicators of performance on credit intermediation – return on equity, return on assets and net income per employee – the BNDES is more efficient than any other development bank (Colby, 2012).

Throughout its history, the major part of BNDES resources has been assigned to projects in the areas of infrastructure and some key manufacturing industries, such as basic inputs and capital goods, supporting the creation of new firms, expansion of existing capacity and/or restructuring production lines through investments in new machinery. However, over the last two decades, BNDES has expanded in two different but complementary ways. *First*, it became present in virtually all sectors of the economy: agribusiness, information technology, aircraft, oil & gas, consumer goods, pharmaceuticals, retail, engineering services, tourism, education, sports and cultural goods. *Second*, it stretched the range of its interventions with

¹ Director of Cindes. I am grateful to Ana Claudia Além, Fabio Giambiagi and Fabrício Catermol for sharing with me their expertise on BNDES, and to Maria-Valéria Junho Penna and Pedro da Motta Veiga for helpful comments and suggestions. However, the views here presented are the author’s own.

operations that included mergers and acquisitions, research and development, export promotion, social inclusion, urban development and environmental protection.

With an overall successful history, some aspects of the BNDES's recent performance merit further analysis, the most noteworthy: [a] its role as an instrument of foreign economic policy; [b] the interplay between its activities and the long run priorities of the Federal Government; and [c] the profile of its funding sources, recently marked by a growing dependency on loans from the National Treasury. This paper seeks to address the first issue, not discarding attention to the others. In conjunction, they point out to the BNDES potentialities in the area of foreign economic policy.

The paper is organized as follows. Section 2 presents a brief account of the Bank's role in different moments of the Brazilian economy since it was launched, offering a backdrop scenario for the discussion in the other sections. Section 3 reviews the Bank's efforts in the areas of export promotion, internationalization of Brazilian firms and financial cooperation with other countries. Section 4 examines three interrelated aspects of BNDES recent performance: the evolution of disbursements over the period 1996–2012, the profile of funding sources and the coordination between the Bank's activities and other governmental priorities. Section 5 concludes the paper.

2. Background history

A major feature of BNDES performance has been the close interaction between the Bank's assignments and the long run goals defined by the Federal Government. This interaction was revised and reinforced several times, in general through explicit measures as the passing of new laws and/or amendments in the Bank's statutes, including during the military governments. Only in more recent years, such procedures became less transparent, with the rationale for some of BNDES activities less evident, as section 4 indicates.

The Juscelino Kubitschek administration (1956–1961) provided the first comprehensive opportunity for BNDES contribution to the Brazilian industrialization with its cornerstone of the Targets Plan (*Plano de Metas*). That Plan summarized an ambitious

investment program that should allow the country to grow “*five decades in five years*” by focusing economic policy in energy, transportation, education, basic industrial inputs and the construction of a new capital, Brasília. In the implementation of that plan, the BNDES (then BNDE) acted as a financial agency, as a think tank that defined the goals to be attained and, more importantly, as a managing board that coordinated the players involved in those actions. Roberto Campos, an economist and diplomat who was then president of the Bank, described that experience as follows:

“The role of BNDES as industrial promoter was particularly important. Strictly speaking, it was BNDES that implemented the Targets Plan. It arranged for the different executive and working groups. As we know, BNDES became the fulcrum of what was called the ‘parallel administration’. Kubitschek did not want to be hemmed in by the usual atomized bureaucracy. The idea behind the executive groups was to form groups organized by BNDES and, therefore, benefiting from the Bank’s logistics and infrastructure and to bring these groups together with the representatives of the different ministries so as to get a joint decision. Without that approach, it would have been extremely difficult to implement the Targets Plan.” (BNDES, 2002)

As a financial agency, the BNDES remained focused on the areas of energy and transport until the late sixties – but also delivering Brasília to where the Federal Government was transferred from Rio de Janeiro in 1961. *Pari passu* to the economic growth of the first decade of the military period, by the early seventies, BNDES broadened its activities to include the modernization and reorganization of a new set of industries, especially those that were predicted to become exporters, as textiles, shoes and apparel, for instance. That new expanded role paved the way to a major change during the President Ernesto Geisel government (1974–1979), when the administration of the PIS-PASEP payroll tax was transferred to BNDES.² With a larger and more stable source of funds, the Bank was prepared to support the new priorities for import substitution established by the 2nd National Development Plan, which included capital goods and basic industrial inputs such as steel, petrochemicals, paper and pulp, and nonferrous metals.

² The Social Integration Program (PIS) and the Public Employee Savings Program (PASEP) were created at the beginning of the seventies through a levy on company profits.

The seventies are usually described as a time of astonishing economic growth, or as the “*decade of the Brazilian miracle*”. A significant part of that dynamism was funded by BNDES, defining the sectors deemed as key for development and looking for entrepreneurs who were apt to occupy those niches. The Bank’s practice followed a guideline set by the Federal government, providing loans at subsidized interest rates to encourage investments in those sectors.

In 1982, the last military government (1979–1984) created the Social Investment Fund (FINSOCIAL) to support food programs, low-income housing, healthcare, education, and assistance for small farmers. When FINSOCIAL regulatory statutes were completed, BNDES created a unit to manage the operational side of that fund. An “S” was added to the Bank’s acronym – for social – to include social concerns in its agenda. With the resources from FINSOCIAL, schools for street children and blood banks were established in several states. Other examples of projects carried out by BNDES in the area of social policy included land settlement for rural workers and a program for running day care centers to incentive the compliance of companies with the pertinent legislation.

Yet, due to the severe economic conditions of the eighties, marked by high inflation, external debt crisis and the uncertainties inherent to the political transition from dictatorship to democracy, the Bank’s applications remained practically frozen at US\$4 billion during that decade (BNDES, 2002). So, while the new agenda engendered innovative projects in the areas of social inclusion and urban development, they did not affect the BNDES profile of disbursements.

The 1988 Constitution introduced a series of changes in the management of the PIS-PASEP payroll tax, creating the Workers Assistance Fund (Fundo de Amparo ao Trabalhador – FAT). The Constitution determined that at least 40 percent of the funds collected by FAT were to be channeled to BNDES investments in employment and income generation projects, a rule that is still in force today. That assignment has prompted an additional challenge for BNDES, since FAT resources belong to the contributors and should be remunerated at market rates.

In the nineties, the Bank's role as an instrument of long run economic policy was, once again, extended. After the trade reform of the Fernando Collor government (1990–1992) and the end of hyperinflation with the Real Plan launched in 1994, the Fernando Henrique Cardoso government (1995–2002) embarked on series of economic reforms that included the privatization of key industries such as mining, steel, telecommunications and electricity. The BNDES began the planning of that privatization process in the late eighties, and, as of 1991, was already providing the administrative, financial and technical support for the auctioning of State-owned firms. The scope of these activities was enlarged during the Cardoso administration and, like in previous occasions, BNDES was responsible for implementing a top governmental priority. Another important innovation introduced during that period was the setting of credit lines to support exports of industrial goods and services. After more than four decades when BNDES worked exclusively within Brazilian borders, the setting of export credit lines marked the entry of the Bank in international activities. In 1997, the building of a road in Ecuador was the first operation approved by the Bank in the area of engineering services.

During the President Luiz Ignácio Lula da Silva government (2003–2010), two new roles were added to BNDES assignments: promoting the internationalization of Brazilian firms – enlarging the scope of the export financing programs set in the previous decade and supporting outward foreign investment of Brazilian companies – and acting as a counter cyclical financial source during the global crisis of 2008–2009. The first role included several types of activities, as strengthening the links between foreign direct investments and the exports of industrial goods and engineering services, funding mergers and acquisitions at home and abroad, and R&D projects. The second role required an unprecedented increase of BNDES disbursements, which scaled up from 2.4 to 4.5 percent of GDP. These new trends are discussed in the next two sections

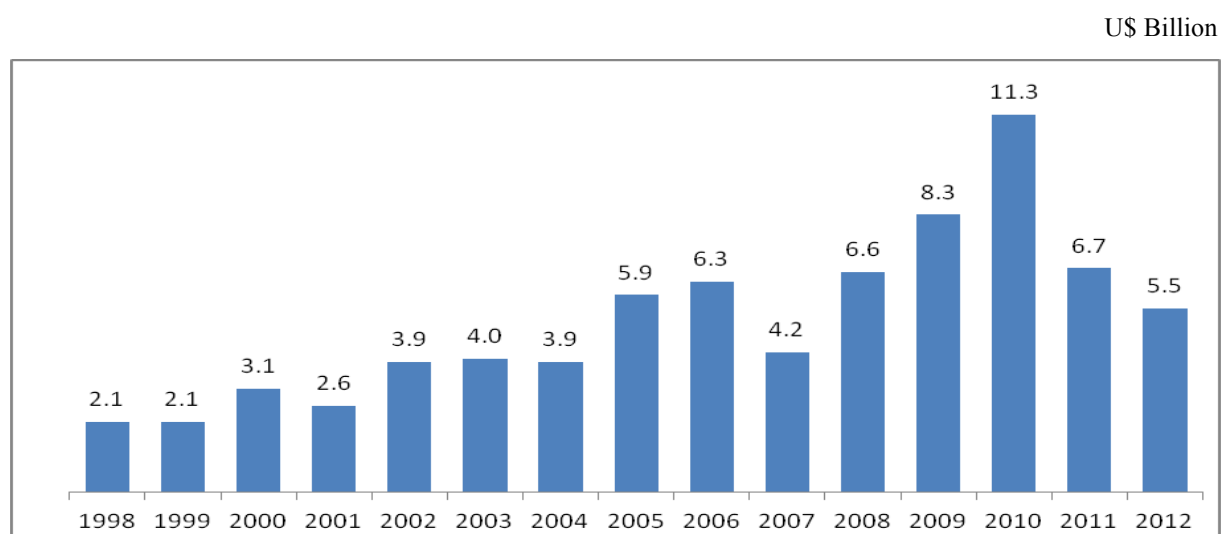
3. The BNDES as an instrument of foreign economic policy

As Graph 1 shows, the support to the internationalization of Brazilian firms has been a clear priority for BNDES over the last decade (Além and Cavalcanti, 2005; Além and Madeira, 2010). Between 2001 and 2010, the amount of export financing operations raised

from US\$2.6 billion to US\$11.3 billion. In spite of the remarkable growth, these operations represent a small fraction of Brazilian total exports, which achieved, for instance, US\$202 billion in 2010. The reason for this disparity lays in the fact that the BNDES actions are focused on industrialized goods, especially those with high technological content, engineering services and software products – which represent a small share of Brazilian exports (Catermol, 2010). It should be noted that the share of high technology products in the Brazilian manufactured exports has declined from 13 percent in 2005 to 10 percent in 2011, according to the World Bank development indicators data base.

Due to the nature of the operations financed by the Bank, the geographic distribution of the goods exported is highly volatile, as Graph 2 shows. However, two clear trends may be noted in recent years: the declining performance of Brazilian exporters in the US market and the growing importance of South American markets for sophisticated goods and services produced in Brazil. Yet, this profile is rather different from the geographic distribution of Brazilian total exports presented in Graph 3. For example, Asian economies, especially China’s, became the principal market for the Brazilian commodities, but has remained relatively inaccessible for other types of goods.

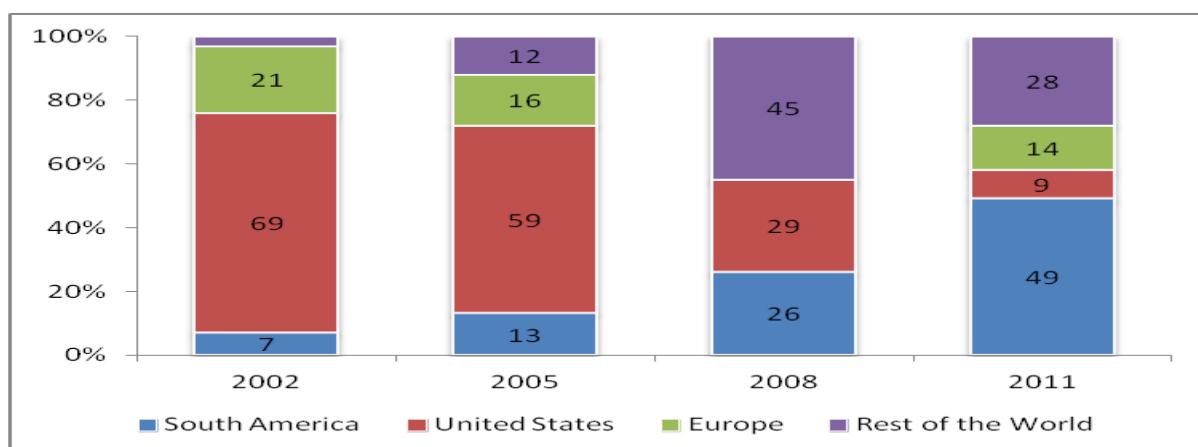
Graph 1
BNDES Export Financing



Source: BNDES.

Regarding services exports, BNDES's disbursements increased from US\$49 million in 1998 to US\$1.4 billion in 2009. The main focus of its credit lines has been on activities that are intensive in intellectual content, such as software and computer services and engineering services in infrastructure projects. In the case of construction and engineering service exports, BNDES has supported projects in South America and Africa, primarily Angola and Mozambique, where the demand for infrastructure is high, and marked by a strong competition from third-country corporations. In the case of software and computer services, the Bank's program *Prosoft Export* focuses on small and medium-size firms, financing investment and business plans, domestic marketing and exports (Marconini, 2012).

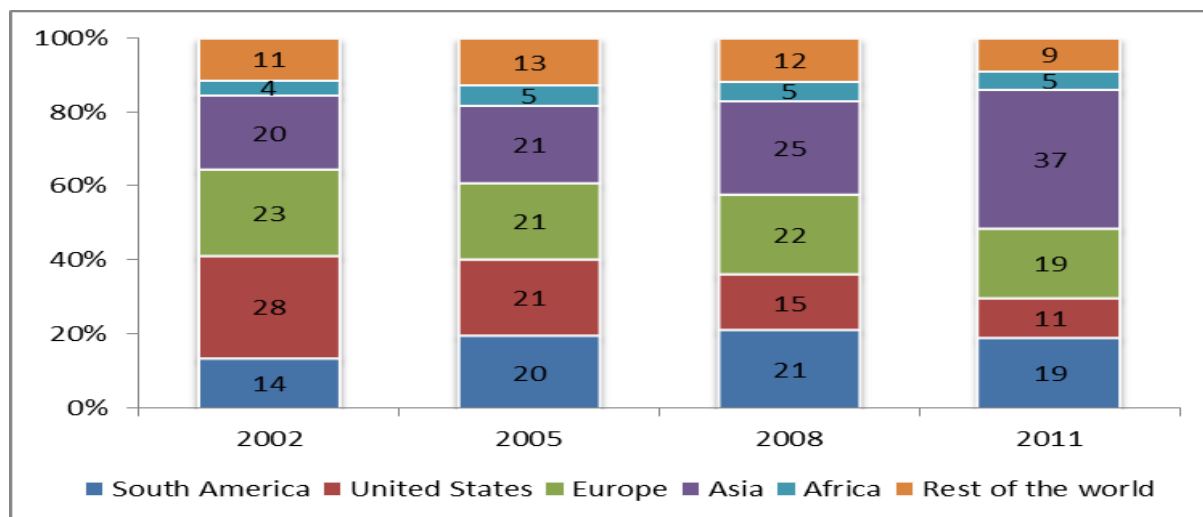
Graph 2
Geographic Profile of the Exports Financed by the BNDES



Source: BNDES

Together with export financing, the BNDES has been supporting a cluster of activities that are crucial for the internationalization process of Brazilian firms, including starting subsidiaries abroad, making strategic partnerships, maintaining long term supply contracts, managing distribution channels and other forms of foreign direct investment (FDI). As Além and Cavalcanti (2005) have reported, the transformation of BNDES into a promoter of FDI has been a gradual process. Until 2002, the support was restricted to a small number of indirect operations, wherein the Bank would participate as a subscriber of securities issued by firms that were doing business abroad. Indeed, such actions were indistinguishable from other operations focused on the domestic market. In other words, it was the firm that had an international strategy, not BNDES.

Graph 3
Geographic Profile of Brazilian Exports



Source: Sistema Alice

In mid-2002, BNDES board approved a set of guidelines to finance the internationalization process of Brazilian firms. To turn those guidelines effective, the Bank's statutes were amended, specifying the rules to be complied by that kind of operation. The most important one is that every FDI operation should boost the export performance of the domestic branch of the firm, with clear targets to be reached within a six year period. Another condition is that only national firms qualify for such funds. The first operation under these rules was approved in September 2005 (Além and Cavalcanti, 2005). Such restrictions were gradually reduced in the second half of the decade. Yet by the beginning of 2013, only 19 FDI operations had been financed by BNDES, and the total disbursement in this credit line reaching around U\$11 billion (the vast majority of the operations refer to acquisitions of foreign firms – not greenfield investments).³

³ It should be noted that the internationalization process of Brazilian firms is yet at an initial stage. The World Investment Report 2013 prepared by UNCTAD presents the list of the top 100 non-financial transnational firms from developing and transition economies in 2011, classified by the amount of foreign assets (FA) and the transnationality index (TIN), which is calculated as the average of three ratios: (i) foreign assets/total assets; (ii) foreign sales/total sales; (iii) foreign employment/total employment. Only four Brazilian firms are included in that list: Vale, Petrobras, Gerdau and JBS. Their rankings are the following: Vale (FA=4; TIN=63); Petrobras (FA=18; TIN=97); Gerdau (FA=29; TIN=55); JBS (FA=54; TIN=51).

These innovations stimulated organizational changes in the Bank. In 2008, an International Division was created to coordinate the new types of operations, with a declared focus on Latin America, the Caribbean and Africa. In August 2009, an office in Montevideo was opened, with the task of facilitating trade and investment in South America. In November 2009, a subsidiary in London was started under the format of an investment holding company, with a wider assignment than the Montevideo's office. Beyond trade facilitation, its role is to enhance the visibility of the Brazilian economy in the international financial community.

Complementing those activities, the Bank has been prolific in signing cooperation agreements and memoranda of understanding with financial institutions from several countries, as Belgium, Canada, China, India, Japan, Korea, Norway, Russia, South Africa and United Arab Emirates. So, notwithstanding the declared priorities on Latin America, the Caribbean and Africa, the scope of BNDES international operations is, indeed, global.

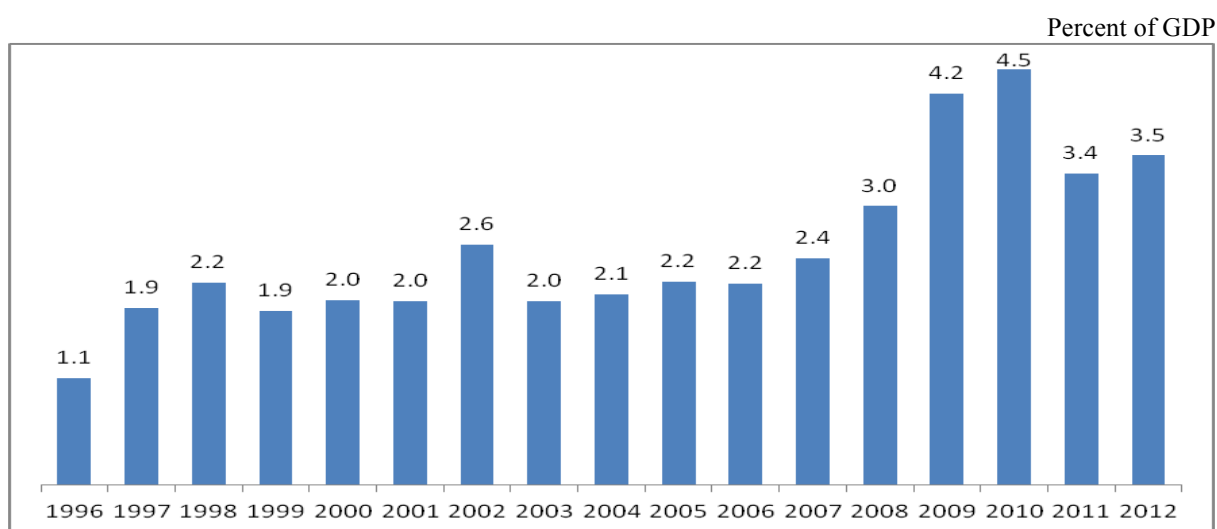
4. The growth of disbursements and the allocation of subsidies

Graphs 4 and 5 describe the evolution of BNDES disbursements over the period 1996–2012. After an initial phase of moderate expansion between 1996 and 2002, the annual figures scaled up from 2.0 to 4.5 percent of GDP during the Lula government (2003–2010). In constant values, the accumulated growth rate of the Bank's operations during those years reached 240 percent. This impressive record shows that the role of BNDES as an instrument of long run economic policy has been preserved as a top priority. In fact, since its foundation, in no other moment of the Bank's history the growth and diversification of tasks had been so intense.

A major part of this performance may be explained by the role played by BNDES since the financial crisis of 2008–2009. To face the crisis, the Brazilian government adopted a series of counter-cyclical monetary and credit measures that included reductions in the compulsory bank reserves, cuts in the prime interest rate and expansion of credit by public banks. Those measures aimed to alleviate the negative effects of the crisis on investment and consumption, through lower interest rates and easier credit. Within this context, the Provisional Measure no. 453 was issued on January 2009, constituting an additional source of

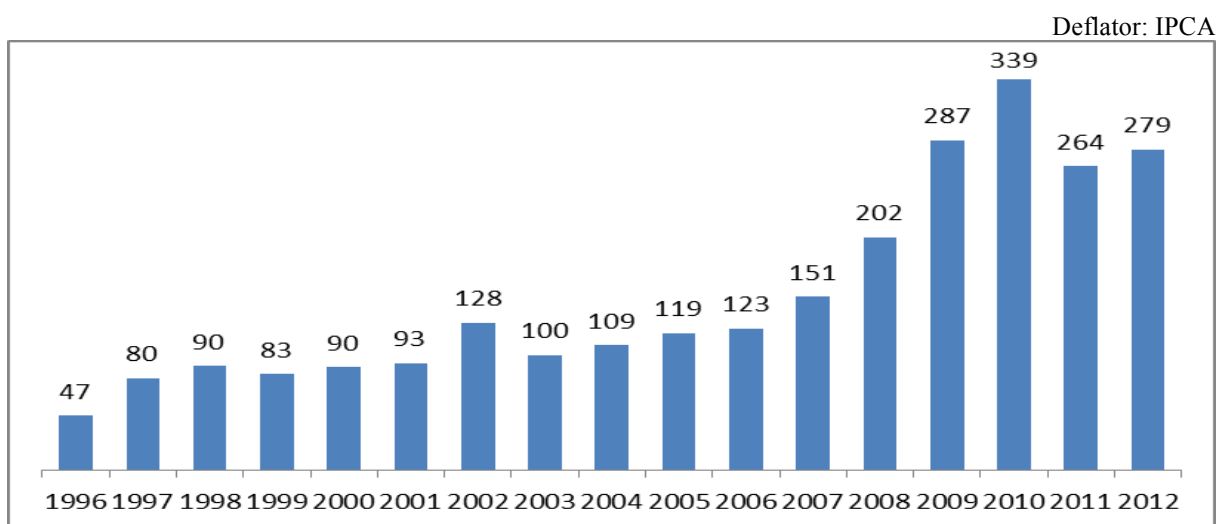
funding for the BNDES amounting to US\$50 billion, with the aim of increasing availability of long term credit. Afterwards, additional transfers from the National Treasury to BNDES were made on several occasions.

Graph 4
BNDES Disbursements: 1996 – 2012



Sources: BNDES and Ipeadata.

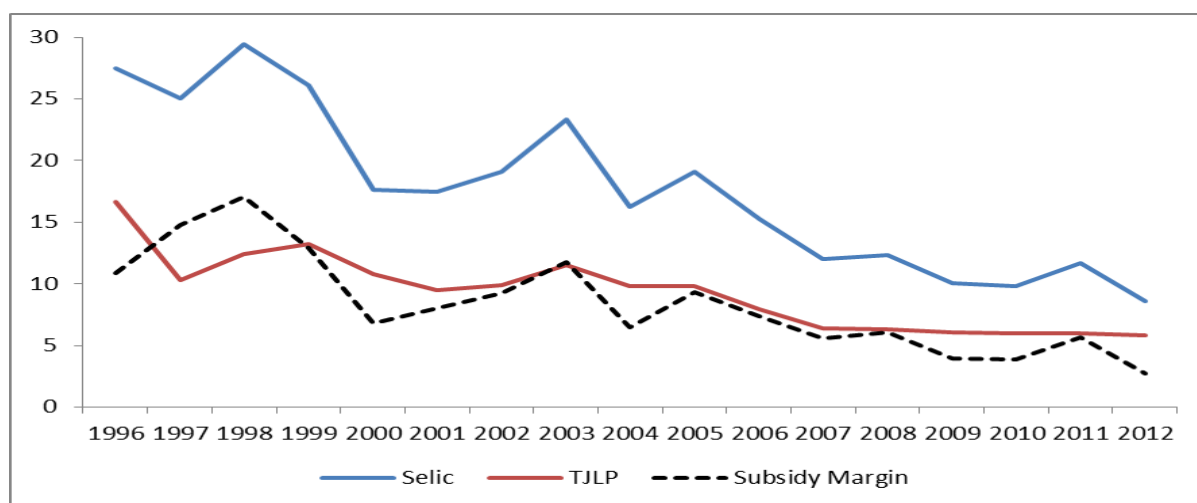
Graph5
Real Growth Index of BNDES Disbursements: 1996 – 2012



Sources: BNDES and Ipeadata.

As the BNDES disbursements are made at subsidized rates, they resulted into a deep State intervention on the allocation of economic resources. The implicit subsidy margin of the Bank’s loans results from the difference between the SELIC (*Sistema Especial de Liquidação e Custódia*)⁴ prime rate and the TJLP (*Taxa de Juros de Longo Prazo*)⁵ rate. The SELIC rate is set by the Central Bank and serves a yardstick for the private credit system. The TJLP rate is the benchmark for the BNDES operations. While the subsidy margin has declined during the last decade, as Graph 6 shows, the *amount* of subsidies has, in fact, increased, due to the high growth rate of the Bank’s disbursements.

Graph 6
SELIC, TJLP and the Subsidy Margin of BNDES Loans



Source: Banco Central do Brasil.

From 2008 to 2010, the accelerated growth of disbursements was followed by the concentration of resources towards two industries: food processing and petroleum. In that period, about U\$16 billion have been channeled to the food industry, and U\$30 billion to Petrobras. Altogether, those loans represented 50 percent of the support provided by BNDES to the manufacturing industry.

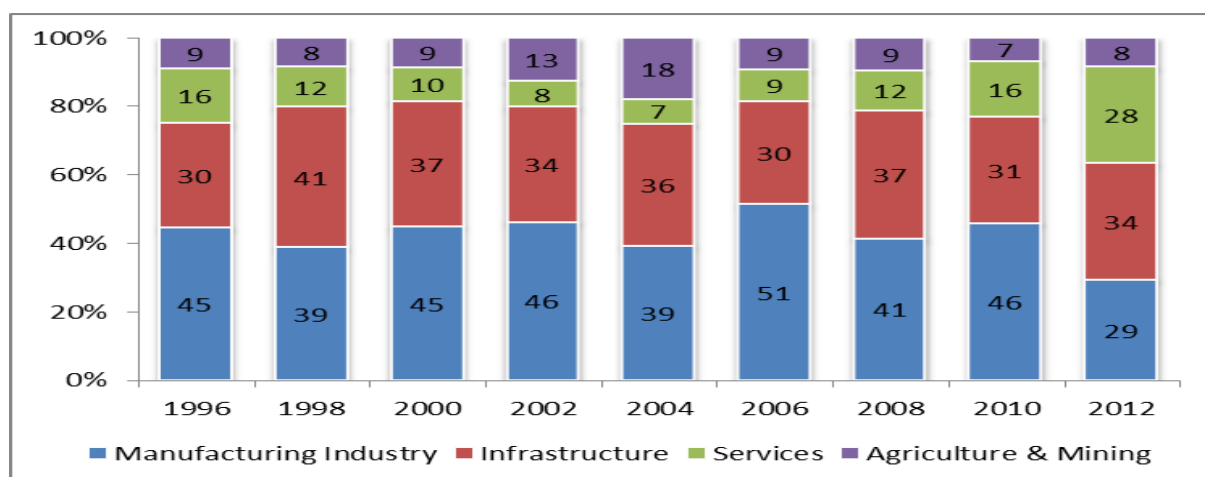
⁴ Special System for Settlement and Custody.

⁵ Long Term Interest Rate.

The logic of these priorities is puzzling. By 2008, the Brazilian food industry was already the third most competitive industry worldwide, as the OECD-WTO database on trade in value added indicates. This position was attained after two decades of radical technological changes being adopted by Brazilian firms to comply with the new safety standards enacted during that period by the international legislation on consumer protection (Tavares, 2013). On the other hand, Petrobras has been the largest Brazilian corporation for many years and is the only South American firm among the 50 most innovative companies in the world (Almeida, 2011). As the leading firms of the food industry, Petrobras has access to credit lines at competitive conditions in many countries. The BNDES administration never explained how the subsidies awarded to these firms would benefit the rest of the Brazilian economy.

Despite these priorities, the BNDES performance in the last decade was marked by important initiatives in many areas, like energy, transportation, export promotion, internationalization of Brazilian firms and technological innovation. In fact, as Graph 7 shows, the profile of disbursements has preserved the historical trend of allocating around 75 to 80 percent of total resources towards infrastructure and the manufacturing industry. However, in 2011–2012, the share of the manufacturing industry has been, for the first time, below 30 percent.

Graph 7
Profile of BNDES Disbursements

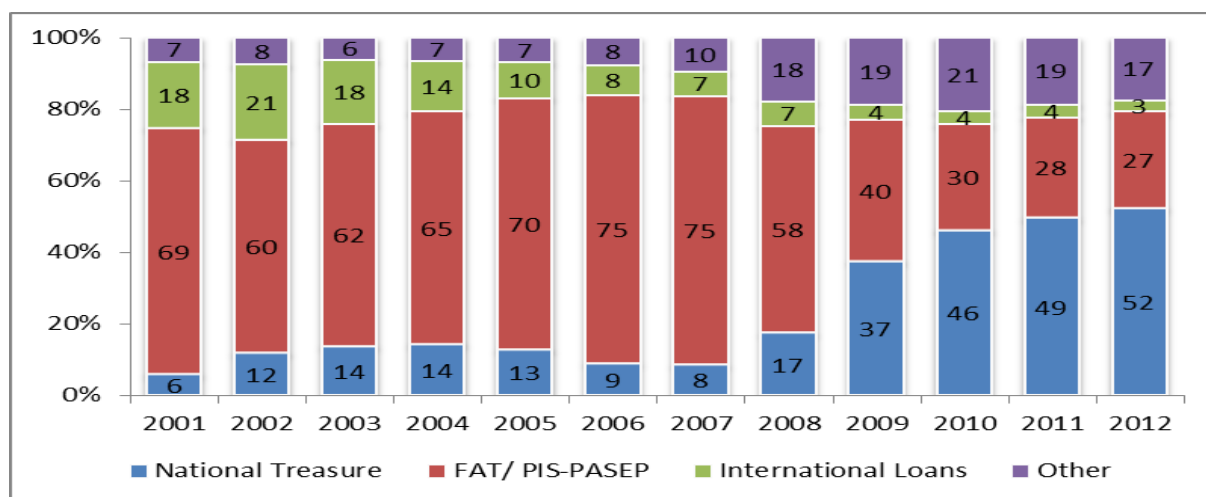


Source: BNDES

4.1. The issue of funding

One of the main features of BNDES in the recent past has been the peculiar structure of its funding sources, wherein the National Treasury was converted into its major financial partner. As Graph 8 reports, the share of Treasury loans in the total funding jumped from 8 to 52 percent between 2007 and 2012. As the government borrows at the SELIC rate and lends to BNDES at the TJLP rate, the resulting loss raises the net debt of the public sector, which, at the end, must be borne by the taxpayer. Moreover, these transactions result in a large transfer of public resources inside the economy without the support of any explicit target set by the government.

Graph 8
BNDES Funding Sources: 2001 – 2012



Source: BNDES

This funding strategy is clearly not sustainable, as other authors have already pointed out (Almeida, 2011; Giambiagi et al., 2009). Thus, sometime in the near future, the government will be compelled to define new forms of capitalizing the BNDES. But, this task probably will engender a political debate that has been avoided so far, regarding the size of the Bank and the guidelines to be followed by the administration in the allocation of subsidies. Indeed, a key feature of the current funding strategy is precisely the circumvention of these issues. A good starting point for that debate would be an assessment of the costs and benefits generated by the priorities adopted by the Bank in the recent past.

5. Conclusion

The recent literature on public development banks (PDBs) has acknowledged the role played by these agencies as long run policy instruments (United Nations, 2005; Smallridge and Olloqui, 2011; Luna-Martínez and Vicente, 2012; Olloqui, 2013). As Smallridge and Olloqui (2011) noted:

“PDBs exist to meet a public policy need. It is therefore critical to ensure that a PDB’s mandate and resources are properly framed relative to the government’s strategy within that public policy domain and the PDB’s own legal foundation. It is also critical that the PDB is supported by an appropriate system of corporate governance, and that the analysis of the market gap—the extent to which the private sector sources of finance and risk capital are unable to meet the needs—is undertaken and feeds into the PDB’s vision and strategy.” (p. 18)

The BNDES performance since 1952 reveals that the attainment of these requirements is a learning-by-doing experience that becomes more sophisticated over the years, especially in regard to the interplay between the Bank’s activities and the political priorities set by the Federal government. On the one hand, a PDB is an instrument for allocating subsidies into selected industries, which often provokes significant changes on the conditions of competition of the national economy, benefiting some sectors and hurting others. On the other hand, a PDB is a financial institution that must remain solid for ensuring its survival in the long run.

With the experience gathered in recent years, the outlook of BNDES as an instrument of foreign economic policy is promising. Nevertheless, currently the main challenge in fulfilling this role is not the lack of financial resources but the risks of inconsistency of such an outward-oriented policy with other economic policies. To be effective, abovementioned activities would require a national industrial policy strictly focused on the promotion of technological innovation and the full exposure of Brazilian firms to international competition. But, coincidentally, as of 2008, when the Bank’s International Division was created, the Brazilian government has returned to old fashioned protectionist policies as tariff escalation, antidumping, national content and other trade barriers. The main side effect of these mechanisms is to raise transaction costs in the Brazilian economy. Hence, they are antithetical to contemporary competition patterns, as lowering transaction costs has turned out into a core

instrument for successful firms in global markets. However, this contradiction may eventually be transitory, since the recent protectionist measures resulted in part from domestic pressures generated by the global financial crisis of 2008–2009.

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