Research briefing:

Earmarking Credit for Investment, Stability and Growth: Lessons from the Brazilian Development Bank

Summary

- Until-mid 2000s, credit to the private sector in Brazil was scarce, short term and costly. Interest rates were high in order to attract foreign investors and to finance the public debt, which reached more than 80% of GDP in 2002 and had to be rolled over every 12 months.
- Brazil's national development bank, the BNDES, holds a market share of over 20% of total credit market and is mainly financed by special funds from the government. On average it finances 25% of all investment in manufacturing and infrastructure.
- From 2004 to 2010, bank credit to the private sector more than doubled compared to GDP, while BNDES expanded its leading position in the long term market as a result of its important counter-cyclical financing.
- BNDES' role has been enlarged in recent years to include new activities such as social investments, innovation and export finance to many countries, including Africa.
- The experience of BNDES is unique in Latin America and shows the importance of creating national development banks as tool to support investment and growth in less developed countries, particularly in Africa.

The Transformation in Brazilian Credit System

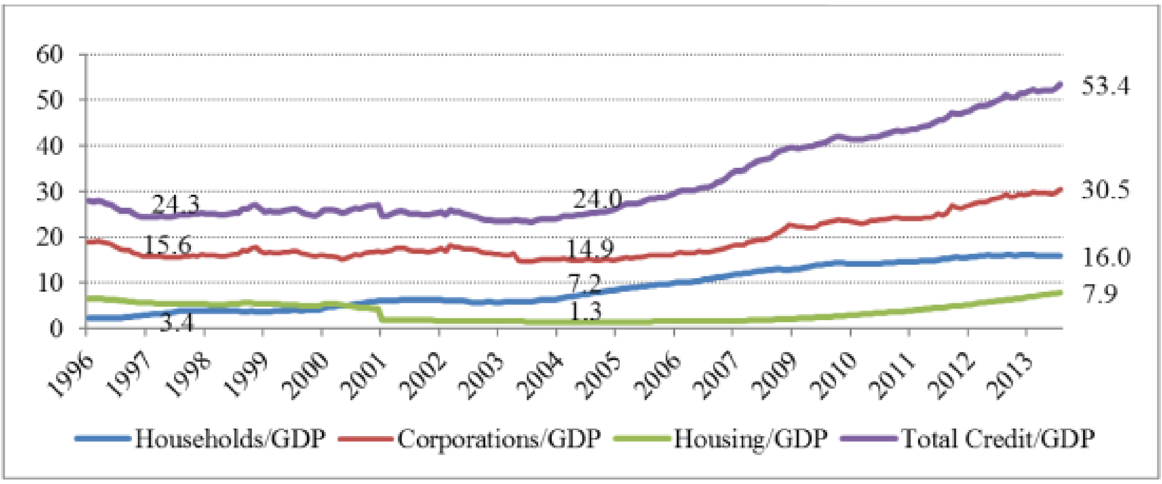
Until the mid-2000s, credit in Brazil was characterized by five salient features:
1. Volatility
2. High costs
3. High concentrations in the banking industry, with the significant participation of state-owned institutions
4. Segmentation, with large quasi-fiscal funds earmarking credit for investments

Today, the Brazilian financial market is very different from the early 2000s. According to the World Bank (2014), domestic credit to the private sector reached 61% of the GDP in 2011, above the world average of 58%. This transformation was concentrated on the second half of the 2000's and was centred upon households and within the housing market. (Figure 1)

From the supply side, the rapid growth of the credit market from 2004 to 2008 was initially led by domestic private banks. They were liquid and sufficiently capitalized to meet the demand, while the state-owned banks lagged behind. They were financially healthy - but too slow to introduce new financial products to compete with the private sector.

Figure 1 – The Evolution of Bank Credit by Sector

Source: Banco Central do Brasil



After Lehman's bankruptcy in September 2008, the situation changed. Private banks became more cautious and decided to curb the expansion of their lending rates. In order to avoid a recession in the manufacturing sector that would result in massive loss of jobs, the government decided to step in. Banco do Brazil, a state-owned commercial bank, expanded its lending to compensate for the retreat of its private competitors. At the same time, BNDES increased its disbursements, guaranteeing the flow of funds to long-term projects. These measures helped stabilize the level of domestic investment. (Figure 2)

The Role of BNDES

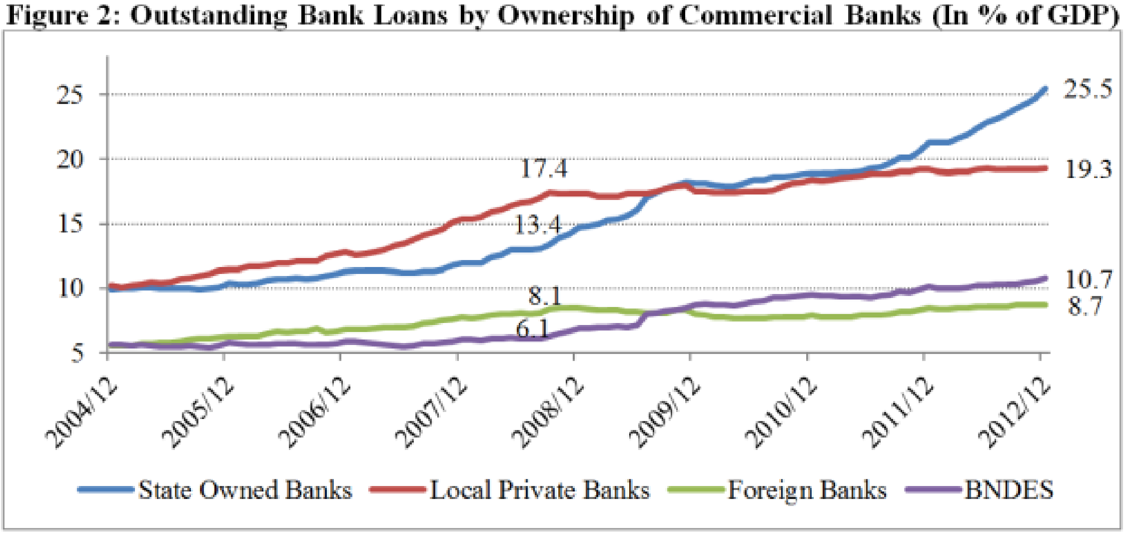
BNDES was created in 1952 as an institutional innovation in the Brazilian banking system to fill an important gap: the provision of long-term loans for investment in manufacturing and infrastructure projects. The shortage of bank loans was considered one of the most important barriers for economic development. It is a bank 100% controlled by the Federal government and today BNDES is one of the largest development banks in the world. It holds almost the same level of assets as the World Bank, but disburses five times more and is much more profitable

Table 1: BDNES, InterAmerican Development Bank and the World Bank (2013)

US$ million	BDNES	IADB	World Bank
Total assets	333,835	97,007	324,367
Equity	25,880	23,550	39,523
Net income	3,479	1,307	218
Disbursements	81,285	10,558	16,030
Return on equity	14,5	5,9	0.6

Source: BNDES

Figure 2: Outstanding Bank Loans by Ownership of Commercial Banks (In % of GDP)



Source: Banco Central do Brasil

Source: BDNES

Figure 3: BNDES' Disbursements by Business Sector (In %)

In the 80's, BNDES started to fund social infrastructure projects in areas such as education, health, water and sewerage, and urban transportation. In the 90's, export finance was also included in its portfolio. However, its core business is still long term finance – predominately loans but also equity–invested in manufacturing and infrastructure projects (Figure 3).

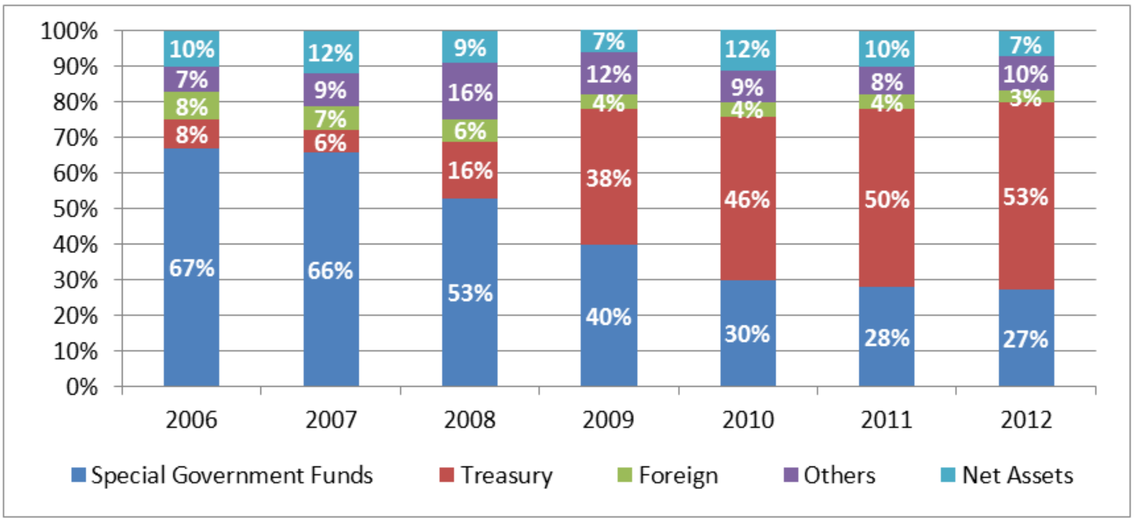
BNDES has always been mainly funded by the public sector. Foreign resources were deliberately minimized to ensure independence from overseas political pressure, as well as insulating it from international financial markets. Domestic private sector funding was too scarce, short term and costly to play a significant role. Therefore, most of the resources managed by BNDES came from the government sector by means of special funds. However, after the 2008 crisis, Treasury loans became increasingly important to leverage sufficient funding to offset the credit squeeze in the private sector. These loans rapidly became BNDES' main source of funds (Figure 4).

BNDES in Africa

BNDES began to finance Brazilian exports to Africa in 2007. For the 2007-2010 period, credit to the continent totalled more than US$ 2 billion. Angola was by far the most important destination of loans, along with South Africa and other Portuguese speaking countries. The loans were related to investment projects in different sectors – including roads, power (generation and transmission lines), water and sewerage systems and airports – that were awarded to large Brazilian private construction companies.

Figure 4. BNDES: Capital Structure (In %)

Source: BDNES



National Development Bank is a Tool to Promote Investment, Growth and Stability

BNDES has been one of the key government institutions in promoting investment, growth and stability in Brazil. It has been an important source of long term credit in local currency for investment projects undertaken by both the public sector and private companies.

It stimulated the localization of high value added industries, supporting them with internationally competitive loans for the sales of their goods and services in the domestic market as well as abroad. It has a leading role in financing large and long term strategic projects, particularly in infrastructure, which is an area underfunded even in developed countries. It has played an important role during times of crisis, helping to offset the credit squeeze within domestic and international financial markets.

Some of the literature suggests that the costs of national development banks are that they can be a source of cronyism and inefficiency, as well as a way to crowd out private investors and financial institutions. We argue that the experience of BNDES shows that the benefits to the Brazilian economy are higher than the costs, if they exist. To avoid those potential negative effects is important to have:

- A secure institutional foundation
- Autonomy on structuring specific financial operations
- A collaborative approach to working with other financial institutions, particularly from private sector and multilaterals
- High levels of transparency

The Brazilian experience demonstrates that developing local capabilities and sources of funds for long term investment is a precondition for sustained economic development.

This briefing is based upon an IRIBA working paper 6, Restructuring Brazil's National Financial System, by Ernani Torres, Luiz Macahyba and Rodriogo Zeidan available at **http://www.brazil4africa.org**

Further reading:

- Lazari, S., Musacchio, A., Bandeira de Mello, R., Marcon, R. (2012). What Do Development Banks Do? Evidence from Brazil, 2002-2009 Working Paper 12-047, http://www.hbs.edu/faculty/Publication%20Files/12-047.pdf
- Oliveira, F. (2013). In-Depth Analyses of Investment of Firms in Brazil: Do Financial Restrictions, Unexpected Monetary Shocks and BNDES Play Important Roles?. Paper presented to the Brazilian Econometric Society Forum. https://editorialexpress.com/cgi-bin/conference/download.cgi?db_name=sbe35&paper_id=14
- Garcia, M. (2010).The Financial System and the Brazilian Economy during the Great Crisis of 2008. ANBIMA. Accessed 18 January 2014. http://www.anbima.com.br/mostra.aspx/?id=1000001381

IRIBA is a DFID funded research programme, based at the University of Manchester. It brings together an international team of researchers, examining how lessons from Brazil's development experience can be learned and adapted for African countries.

July 2014

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