

BRICS INSIGHTS PAPER 5

Regional Financial Institutions and the Role of the BNDES in Latin America

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Introduction

The expanding influence of emerging economies in the last few decades can be seen in many areas. From an economic perspective, this is evident in their recent economic performance and their increasing participation in global trade and investment. This is especially true in the case of the BRICS countries, whose growing economic clout is reflected in their move to establish their own development bank and emergency reserve fund. At the same time, the national development banks of developing countries such as Brazil and China are becoming more important – at least in terms of the volume of lending – than institutions such as the World Bank.

Monetary and financial co-operation: theoretical features and the case of Latin America

Arguments for monetary and financial co-operation

Initiatives aimed at regional monetary co-operation have gained momentum since 2000 in a response to the lack of initiatives to reform the international financial architecture. More generally, regionalism can also be seen as part of the process in which bilateral and/or plurilateral agreements are made as a response to the impasse at the multilateral level. In the case of developing countries, regional economic co-operation could help to counterbalance the reduction in economic policy autonomy that results from globalisation, a task that global governance structures have not fulfilled effectively over the past few decades.

Regional economic co-operation can also be effective in setting a line of defence against international financial crises through access to regional reserve funds and reciprocal credit agreements, as well as by facilitating the co-ordination of macroeconomic policies. At the same time, regional and sub-regional development banks can play an important role in supporting investment in infrastructure and other regional public goods.

International and regional institutions can operate in a complementary way. Specifically, regional institutions can fill gaps in the international financial architecture by being more prepared to understand and fulfil the needs of smaller economies. In this sense, there is scope for a division of labour in which global institutions focus on large economies and regional institutions set their sights on smaller economies by providing supervision and financial assistance.

Regional monetary and financial co-operation occur on three different levels, according to the degree of integration. The first involves the provision of long-term financing by regional development banks and regional capital markets. The second seeks to deal with matters such as balance of payment constraints and currency mismatches through mechanisms such as short-term external financing, local currency trade-related payment systems, bond issuances and loans. Deeper levels of integration would include exchange rate mechanisms and a monetary union. In Latin America, efforts towards regional monetary and financial co-operation have mostly been directed at the first two levels, while moves towards deeper integration have been far more limited.

Financial and monetary co-operation in Latin America

Over the last few decades, short-term external financing and insufficient volumes of long-term credit in Latin America have contributed to the relatively low growth in the region compared to other developing regions, especially Asia. A lack of long-term credit remains problematic in the region.

Regional financial facilities such as the Reciprocal Payment and Credit Agreement, the Latin America Reserve Fund and the Local Currency Payment System have sought to deal with balance of payment problems in Latin America. A second group of institutions and facilities – which includes the MERCOSUR Structural Convergence Fund, the Financial Fund for the Development of the River Plate Basin, the Development Bank of Latin America, the Foreign Trade Bank of Latin America, the Brazilian Development Bank (BNDES) and the Bank of the South – seek to boost access to long-term credit in the region. Other important regional financial institutions include the Venezuelan Economic and Social Development Bank, the Inter-American Development Bank and the Caribbean Development Bank.

The regional role of the BNDES

Founded in 1952 to provide long-term financing, the BNDES has been a key actor in the development and industrialisation of the Brazilian economy. Although its main function as long-term credit provider has remained unchanged, its scope has broadened to include the financing of investment projects, equipment acquisition and export of goods and services. The BNDES's main objective is to finance activities related to the social and economic development of Brazil. Externally, the BNDES's cross-border activities include the provision of technical and financial support to structure projects that promote Brazilian economic and social development or aid the country's integration with the rest of Latin America. Regardless of its high volume of external operations, the BNDES's goals are ultimately directed towards national development and supporting Brazilian firms.

In 1990, the BNDES started an export financing line called FINAMEX, which was designed to promote the export of capital goods. In 1997, when it acquired its current denomination, BNDES-exim, the programme was extended to finance a broader range of products, such as non-durable goods and engineering services. BNDES-exim performs a similar role to export credit agencies (ECAs) around the world. By providing long-term credit and loans to small and medium enterprises or to sectors with high technological content and operating in highly competitive markets, ECAs finance operations that would not occur under regular market conditions. BNDES-exim provides both post- and pre-shipment credit lines. Pre-shipment lines are purely a domestic operation, since they finance

the domestic stage of the production process, while the post-shipment line finances foreign firms or financial institutions. In 2013, the value of total disbursements to export financing programmes reached \$7.1 billion, of which the post-shipment line accounted for 35%.

BNDES financing to Latin America

The bulk of post-shipment credit is provided for infrastructure and capital goods. The financing of exports to Latin America has dominated the BNDES's disbursements in recent years.* In 2013, the region was the destination of 57% of the loans, up from 34% in 2009. The US (27% of all loans) is also an important destination for financed exports from Brazil, although its share has fallen in recent years. Outside South America, Angola is a major destination of financed exports.

Focusing on Latin America, in 2013 the financing of exports to Venezuela accounted for 40% of total disbursements, followed by Cuba (18%), Peru (14%), Argentina (11%) and Ecuador (5%). The share of disbursements for financing exports to Argentina has declined significantly recently, and Venezuela has taken up much of this share. In fact, Venezuela is one of the main reasons for the increased disbursements directed to Latin America. Between 2009 and 2013, disbursement for exports to Venezuela grew by more than 1 000%. Over the same period, disbursements for exports to Cuba also grew strongly from a relatively high basis, expanding by 269%.

There are two main reasons behind the recent heightened importance of Latin America as a destination of financed exports. The first is the decline in disbursements for exports to the US. The second is the greater dynamism of disbursements to finance exports to Latin America, reflected in the growing shares directed towards Venezuela and Cuba in particular.

Disbursement for infrastructure in Latin America

Between 2009 and 2013, around 99% of disbursements went to the infrastructure and capital goods sectors. An analysis of disbursements by exporting company shows that construction, capital goods and engineering services exports were among the largest receptors. Therefore, the vast majority of disbursements were directed to investments, which demonstrates the important role the post-shipment credit line can play in the region.

* All disbursements figures mentioned have the BNDES as source. See BNDES (Brazilian Development Bank), http://www.bndes.gov.br/SiteBNDES/bndes/bndes_pt/Institucional/BNDES_Transparente/Estatisticas_Operacionais/exportacao.html.

Over the past five years, the total value of disbursements to infrastructure was \$11.9 billion. Focusing only on Latin America, disbursements for exports of infrastructure goods and services stood at \$1.03 billion in 2013, accounting for 79% of the infrastructure total and 41% of total disbursements. From 2009 to 2013, disbursements to the sector in Latin America totalled \$4.09 billion, representing 64% of total disbursements for infrastructure and 24.3% of the overall total. The growth in disbursements to infrastructure in Latin America over this period was 82.5%. Financing for infrastructure is restricted to Latin America and Africa. Thus, the remaining share (21% in 2013 and 36% for the period) represents financing for exports to Africa.

Financing for Latin America – market or state driven?

It is possible to make a distinction between processes of integration conducted by market forces (regionalisation) and by national states (regionalism). This is an important distinction in terms of the role and operations of the BNDES in the Latin American region. As a *national* development bank, the expansion of disbursements to Latin America would be more related to market forces than the will of national states to integrate. Since 2003, when Luiz Inácio Lula da Silva became president, Brazil has attached more importance to sub-regional (South American) and South–South integration. This is evident in initiatives such as the Union of South American Nations, which was created in 2008. Such changes are also evident in the orientation of the BNDES. The Brazilian government, especially under Lula, used the bank as a funding mechanism for regional development on a more ‘solidary’ basis in comparison to financing from traditional multilateral development banks. When comparing foreign policy with the actual performance of the BNDES, however, it is not so clear that this broader change influenced its actions.

Venezuela, the US and Argentina are among the main importers of Brazilian goods and services. This helps to explain the high volumes of disbursements of financing for exports to these countries. The position of the main recipients of disbursements is compatible with their economic importance to and trade with Brazil. Thus, contrary to the theory on regional banks’ functions, which states that finance should flow towards less-developed countries, until 2009 the BNDES’s post-shipment disbursements appeared to follow the dynamics of Brazilian trade. The succeeding years have reinforced this argument, since the growth of disbursements was higher for countries with better economic performances, suggesting that the actions of the BNDES are not particularly influenced by the government’s policy towards deeper integration.

BNDES staff members have intimated that the performance of the bank is more market driven in the sense that it responds to demand for financing, which depends on the performance of Brazilian exports and on Brazilian companies' interest in opening new markets within the region. This last factor (the search for new markets) may be a key explanation for the resources directed to Cuba, since its disbursements have been very high when compared to the size of its economy or its volume of trade with Brazil.

Debate over the international role of the BNDES

Various criticisms have been raised over the international role of the BNDES. Some domestic opponents[†] question the merits of providing finance to other countries' companies and governments (in the case of public infrastructure projects) while Brazil still has serious infrastructure and credit needs. The concentration of resources directed to certain companies is also a focus of domestic criticism. Over the past five years, for instance, financing of exports from only two firms – Odebrecht (construction) and Embraer (aircraft manufacturer) – received 81% of the total disbursements.

There is also some opposition from countries receiving BNDES credit for large infrastructure projects. Some of this criticism relates to the sustainability of these projects. In some cases, financed projects have significant environmental and social impacts, while at times also failing to address indigenous rights adequately, provide better access to information or promote transparency and active citizen participation.

The role of the BNDES as an instrument to drive regional integration has also been questioned. Although claiming to promote integration, BNDES financing (as well as initiatives such as the Initiative for the Integration of Regional Infrastructure of South America) is directed towards mere physical connections among countries. This is a necessary but not sufficient condition for economic integration.

Another issue relates to the nature of the development promoted by such initiatives. These initiatives tend to reinforce the idea of open regionalism in which regional integration is just a first step in the preparation for and adjustment to global integration. Recent initiatives have prioritised commercial benefits, while structural change and technological progress appear to have no role.

[†] Among them the main opposition party, the Brazilian Social Democracy Party. See PSDB (Brazilian Social Democracy Party), <http://www.psdb.org.br/nota-psdb-sobre-financiamentos-bndes-em-cuba/>

Conclusion

The BNDES is a national development bank whose ultimate goal is to promote national development. Even so, through its post-shipment credit line it has been directing a substantial volume of resources to finance the purchase of Brazilian goods and services by foreign companies and governments. The concentration of resources in infrastructure and capital goods and the increasing volumes of disbursements to the region relative to other areas suggest that it plays an important role in the financing of regional investment.

However, important issues remain. If Brazil wants to promote sustainable development through the BNDES and help the region to overcome secular problems and reduce regional asymmetries, its functions will need to be reevaluated. More than being a paymaster, it should focus on investments that address technological and human capital gaps, reduce external vulnerability and facilitate integration into dynamic global value chains. Social and environmental prerequisites for loans should also be a feature of the BNDES's (and other regional financial institutions') disbursements. With better economic (length and cost) conditions and stricter social and environmental requirements, these institutions could provide a true alternative to private sector finance and make sustainable projects viable. In addition, regional integration should be carried through multilateral institutions that could provide better (more democratic) governance to prevent the process from being subject to the will of a sole country and the swings of its foreign policy orientation.

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