Can the Industrial Development Corporation (IDC) of South Africa emulate the success of the Brazilian Economic And Social Development Bank (BNDES) in financing enterprises and boosting manufacturing?

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FACULTY OF COMMERCE LAW AND MANAGEMENT

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at the

UNIVERSITY OF THE WITWATERSRAND

SUPERVISOR: Prof. Dr. E. Schaling
DECLARATION

I, Nomathamsanqa Mqoqi declare that the research work reported in this dissertation is my own, except where otherwise indicated and acknowledged. It is submitted for the degree of Master of Finance and Investment in the University of the Witwatersrand, Johannesburg. This thesis has not, either in whole or in part, been submitted for a degree or diploma to any other universities.

Signature of candidate ___________________________ Date ___________________________
Abstract:

This paper attempts to answer if the Industrial Development Corporation (IDC) can or should emulate the funding methodology of the Brazilian Economic and Social Development Bank (BNDES). The funding methodology of BNDES is discussed in terms of how it sources and applies its funds within the Brazilian economy following the Brazilian government’s strategy; compares this to industrial policy formulation in the South African economy and the IDC taking into consideration the South African economic structures, banking system and the multiple developmental institutions South Africa has. The conclusion answers if South Africa will be able to emulate BNDES.
<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Full Form</th>
</tr>
</thead>
<tbody>
<tr>
<td>ANC</td>
<td>African National Congress</td>
</tr>
<tr>
<td>ASGISA</td>
<td>Accelerated and Shared Growth Initiative for South Africa</td>
</tr>
<tr>
<td>BNDES</td>
<td>Banco Nacional de Economico e Social (Brazilian Economic and Social Development Bank)</td>
</tr>
<tr>
<td>CPI</td>
<td>Consumer Price Index</td>
</tr>
<tr>
<td>DFIs</td>
<td>Development Finance Institutions</td>
</tr>
<tr>
<td>EDD</td>
<td>Department of Economic Development</td>
</tr>
<tr>
<td>EMEs</td>
<td>Emerging Market Economies</td>
</tr>
<tr>
<td>GDP</td>
<td>Growth Domestic Product</td>
</tr>
<tr>
<td>IDC</td>
<td>Industrial Development Corporation</td>
</tr>
<tr>
<td>IMF</td>
<td>International Monetary Fund</td>
</tr>
<tr>
<td>IPAP</td>
<td>Industrial Policy Action Plan</td>
</tr>
<tr>
<td>NEPAD</td>
<td>New Partnership for Africa’s Development</td>
</tr>
<tr>
<td>NGP</td>
<td>New Growth Path</td>
</tr>
<tr>
<td>PAC</td>
<td>Growth Accelerated Program</td>
</tr>
<tr>
<td>SARB</td>
<td>South African Reserve Bank</td>
</tr>
<tr>
<td>SOEs</td>
<td>State Owned Entities</td>
</tr>
<tr>
<td>WEF</td>
<td>World Economic Forum</td>
</tr>
<tr>
<td>WTO</td>
<td>World Trade Organisation</td>
</tr>
</tbody>
</table>
INTRODUCTION
In his state of the nation address on February 11, 2010 the President of South Africa; Mr. Jacob Zuma stressed the importance of development finance institutions taking a leadership role in poverty alleviation and development of the South African economy. In his speech the Industrial Development Corporation (IDC) was specifically named to take this leadership role. On June 01, 2010, the Minister of Economic Development (EDD), Mr Patel, in his report to the economic parliamentary portfolio committee stressed the importance of the IDC taking a leadership role and emulating the success of the Brazilian Economic and Social Development Bank (BNDES) in growing its economy through financing enterprises and boosting manufacturing.

Development finance has a crucial role to play in economic development, including industrial development more specifically. Successful industrialising countries like Brazil, Japan, Korea, China etc. have generally acknowledged that market failures mean that private sector financial institutions generally will not recognise the opportunities and wider social economic returns from industrial projects (Maia, 20051). These projects may be important for industrial development for various reasons, including: their linkages and positive externality effects; the large scale nature of the investment; the development of new industries or fields in which the country can develop dynamic comparative advantage over time; and because of the impact on particular regions and/or development objectives.

The IDC has undoubtedly played such a role, as part of the apartheid state’s industrial policy. It supported heavy industries such as iron & steel, basic chemicals and defence and was highly successful in meeting its strategic objectives at the time. Indeed, firms such as Iscor (ArcelorMittal) and Sasol provide case studies of infant industries that have ‘grown-up’ to be successful internationally competitive private firms. The challenge now for the IDC is to realise its role and meet expectations within the South African economy by aligning itself with government’s long term planning and overarching industrial policy to ensure sustainable job creation.

The Banco Nacional de Desenvolvimento Econômico e Social (BNDES) the second biggest development bank in the world; is the government development bank in Brazil and has been heavily involved in the development of minerals and resource-based industry in that country (Gil, 2008). In recent years it has diversified its activities and increased lending to services and infrastructure related industries. It has also been successful, as part of government’s industrial policy, in supporting dynamic industries such as aerospace. Its lending increased rapidly in the early 1990s from US$3bn to almost US$10bn by the end of the decade (Gil, 2008). In addition to its activities as a development bank, BNDES also plays an important role in formulating Brazilian development policies and identifying solutions to structural problems in the Brazilian economy.

1 Referencing corrected as per number 1 of internal examiner’s report.
Development finance is thus an important tool in government’s economic policy tool box; its impact depends on effectively designing the means for its application in the interests of the democratic government’s far reaching objectives and mandate.

2 RESEARCH COMPONENT
BNDES funding methodology is seen by the South African government a best to be emulated by IDC in terms of financing enterprises and boosting industrial capacity. BNDES’s methodology involves application of funds to innovation projects, Growth Accelerated Programs (PAC) and energy, infrastructure projects; focus on expanding the equipment and inputs for agro-business, automotives, garement and shoe industries, with other funds placed in projects that will enhance productive capacity and increase capital goods.

This paper will build up on a paper written by Maia, Mondi and Roberts (2005) and attempts to answer if the IDC can or should emulate the funding methodology of BNDES. This research paper discusses the funding methodology of BNDES in terms of how it sources and applies its funds within the Brazilian economy following the Brazilian government’s strategy; compares this to industrial policy formulation in the South African economy and the IDC taking into consideration the economic structures, banking system and the fact that South Africa has more than one development finance institution (DFI); and at the end assesses whether the IDC will be able to emulate the success of BNDES.

3 PROJECT OUTCOMES
This report will investigate and answer how BNDES sources its funds and applies its funds and the discussion will include the following:

- The long-term strategy of Brazil, the basis of industrial policy in Brazil and how long it has taken that economy to realize its strategy and the role of BNDES in the formulation of industrial policies;
- How BNDES created its monopoly taking into consideration the effects of the recession in the early 90’s;
- the state of commercial banks in Brazil, that is, is BNDES in competition with commercial banks in Brazil or do they collaborate in funding;
- Evolution of the financial environment and how it has benefited BNDES;
- Application of funds in the Brazilian economy including the percentage split between the SME sector, medium and long term funding;
- Performance over the past 10 years including benchmarks on output performance of BNDES in relation to IDC and other development financial institutions (DFIs) in emerging markets.

\[2\] Paragraph corrected to provide meaningful paragraph.
4 STRUCTURAL BACKGROUND OF SOUTH AFRICA AND BRAZIL

4.1 OVERVIEW OF ECONOMIC STRUCTURE

South Africa and Brazil are plagued by structural inequalities which stem from the apartheid legacy for South Africa and years of military rule and unstable economic policies for Brazil. Both countries have the largest income inequalities compared with other emerging markets with the wealth of the economy sitting with the minority of their population as depicted by the Table 4.1 below.

Table 4.1 Income distribution by latest year

<table>
<thead>
<tr>
<th>Country</th>
<th>Gini Index /1</th>
<th>Bottom 20%</th>
<th>Top 20%</th>
<th>Latest year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Argentina</td>
<td>50</td>
<td>3.4</td>
<td>53.9</td>
<td>2005</td>
</tr>
<tr>
<td>Australia</td>
<td>35.2</td>
<td>5.9</td>
<td>41.3</td>
<td>1994</td>
</tr>
<tr>
<td>Brazil</td>
<td>55</td>
<td>3</td>
<td>58.7</td>
<td>2007</td>
</tr>
<tr>
<td>Chile</td>
<td>52</td>
<td>4.1</td>
<td>56.8</td>
<td>2006</td>
</tr>
<tr>
<td>China</td>
<td>41.5</td>
<td>5.7</td>
<td>47.8</td>
<td>2005</td>
</tr>
<tr>
<td>India</td>
<td>36.8</td>
<td>8.1</td>
<td>45.3</td>
<td>2005</td>
</tr>
<tr>
<td>Indonesia</td>
<td>39.4</td>
<td>7</td>
<td>47.3</td>
<td>2005</td>
</tr>
<tr>
<td>Mexico</td>
<td>48.1</td>
<td>4.6</td>
<td>53.3</td>
<td>2006</td>
</tr>
<tr>
<td>Russia</td>
<td>37.5</td>
<td>6.4</td>
<td>44.1</td>
<td>2005</td>
</tr>
<tr>
<td>South Africa</td>
<td><strong>57.8</strong></td>
<td><strong>3.1</strong></td>
<td><strong>62.7</strong></td>
<td><strong>2000</strong></td>
</tr>
<tr>
<td>United Kingdom</td>
<td>36</td>
<td>6.1</td>
<td>44</td>
<td>1999</td>
</tr>
</tbody>
</table>

Source: World Bank, World Development Indicators 2009

1/ A measure of distribution of income or consumption, where 0 represents perfect equality and 100 represents perfect inequality

Post the 1994 Democratic elections, South African followed sound macroeconomic policies, underpinned by a consistent and transparent policy framework, contributed significantly to the expansion of the country by strengthening public finances, maintaining single digit inflation, and improving external reserves. South African output growth remains low compared to other emerging markets, even during the economic expansion (commodity boom) of 2004-07. Despite strong employment growth over the past several years, unemployment is still high at over 24.3% as depicted by graph 4.1 below\(^3\), even as the labour force participation remains lower than other emerging economies.

\(^3\) Statistics South Africa
The immediate challenge for the South African Reserve Bank - in terms of macroeconomic policies is to strike the right balance between supporting domestic demand and maintaining price and external stability. Going forward, the challenge will be to ensure that the fiscal position remains sustainable given spending pressures and large external deficits, while a renewed push on structural reform to address long-standing barriers that constrain growth and employment (BMI South Africa Commercial Banking Report, Q4 2010).

Source: CIA factbook, unemployment rates 2010.
Brazil is a democracy with three independent branches of government, similar to the United States. Foreign ownership is legal in most businesses, with the exception of banking. Former President Cardoso was the stabilizing force of the Brazilian leadership because of his free-market advocacy and commitment to low inflation (Brazil, The economist Intelligence Unit Report, 2008). However, corruption still poses a problem; in 2008’s report by Transparency International’s Perception Report, (an anti-corruption organization based in Berlin) Brazil was ranked 80th out of 179 countries studied (Data monitor, June 2009).

4.1.1 Policy Discussion

Globally macroeconomic policies face the difficult task of supporting domestic demand while maintaining macroeconomic stability. The widening output gap and declining employment levels warrant countercyclical fiscal and monetary policies (IMF, Economic Outlook 2009). However, these policy responses need to be calibrated to preserve external and price stability, given the still unsettled global environment and stubborn domestic inflation.

For South African growth prospects the fact that the external current account deficit is expected to remain high over the next several years; maintaining medium term sustainability will be important to retain foreign investors’ confidence (IMF South Africa, July 2009). In Brazil, through the adaptation of keeping mainstream macroeconomic policies, the administration of President Cardoso reduced the economy’s structural vulnerabilities which led to hyperinflation in the early nineties. The three pillars of the framework, namely; a floating exchange rate, an inflation targeting regime and the generation of primary fiscal surpluses; which had been put in place to foster stability coupled with favourable global financial and economic conditions led to broad price and exchange-rate stability and helped to lay the basis for sustained economic growth (Economist Intelligence Unit Limited, Brazil 2008). High public borrowing needs, persistently high interest rates, a complicated tax regime and years of public

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4 Please refer to point 3 of addendum attached.
underinvestment in infrastructure remain challenges that limit Brazil’s potential Growth Domestic Product (GDP). These contribute to the high cost 7.3 (% of income per capita) of doing business in the country compared to 6% for South Africa (IFC, Doing Business Brazil, South Africa; 2011).

4.1.2 South Africa
A favourable external environment and strong domestic demand, accommodated by rapid credit expansion, raised growth to 5 percent on average in 2004–07 and lowered the unemployment rate by 5 percentage points, despite growing labor force participation.

Table 4.2: Labour force participation rate

<table>
<thead>
<tr>
<th>Country</th>
<th>Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>China</td>
<td>73</td>
</tr>
<tr>
<td>Brazil</td>
<td>65</td>
</tr>
<tr>
<td>Australia</td>
<td>62</td>
</tr>
<tr>
<td>Indonesia</td>
<td>62</td>
</tr>
<tr>
<td>Russia</td>
<td>59</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>59</td>
</tr>
<tr>
<td>Argentina</td>
<td>58</td>
</tr>
<tr>
<td>Mexico</td>
<td>58</td>
</tr>
<tr>
<td>India</td>
<td>55</td>
</tr>
<tr>
<td>Chile</td>
<td>51</td>
</tr>
<tr>
<td>South Africa</td>
<td>41</td>
</tr>
</tbody>
</table>

Source: World Bank, World Development Indicators 2009

Sound macroeconomic policies, underpinned by a consistent and transparent policy framework, contributed significantly to the expansion by strengthening public finances, maintaining single digit inflation, and improving external reserves. Rising employment, personal income, and wealth effects buoyed household consumption, while strong business confidence and high commodity prices supported private investment. Surging investment and a falling saving rate resulted in a widening current account deficit, which was financed largely by portfolio inflows. However, the demand-led expansion, together with soaring international food and fuel prices, also created inflation pressures and led the South African Reserve Bank (SARB) to embark on a tightening cycle in mid-2006. The slowdown in the global economy, power shortages, and rising interest rate dampened growth starting mid 2008, (IMF South Africa, July 2009).

Even during the economic expansion of 2004–07, output growth was lower than that in many other Emerging Market Economies (EMEs). Despite strong employment growth over the past several years, the unemployment rate is very high at over 23 percent, even as labor force participation remains lower
than in other emerging market economies. Income inequality, amongst the highest in the world, has improved only modestly over the past decade despite steadily rising public spending on social services and transfers.

**Evolution of South African Economy**

**1940s**

The 1940s saw the end of World War 2 with mass shortages of industrial goods; and at that time the South African economy was largely based on agricultural production and gold mining. At this stage the South African government focused in growing the manufacturing industry especially the food processing and textiles sectors.

**1950-1960s**

During the 1950s and 1960s, South Africa faced a threat of isolation from the rest of the world because of apartheid regime. At this stage securing energy and increasing natural resources beneficiation was the key priority. Projects in petroleum industries (Sasol), fertilizers (Foskor), wood processing (Sappi), chemical beneficiation (Sasol) and mining and minerals (Iscor) were developed to ensure the sustainability of the country.

**1970- 1980s**

The political environment was rife and the South African government focused on decentralisation policy which increased isolation of the country from the rest of the world. The imposed sanctions to the country meant that the country had to be self sufficient. During this error the government strategy focused on creating industries that replaced whatever South Africa was importing. More resource intensive industries were established mainly to bolster export earnings in non-gold sectors and high tech industries were initiated.

**1990s**

The first democratic elections were held and sanctions were relaxed and South Africa was integrated back into the world economy. Government was faced with addressing the disparities created by the apartheid regime. The main focus was on regional integration through New Partnerships for Africa’s Development (NEPAD) and World Trade Organisation (WTO). Black economic empowerment (BEE) policy was created in a move to integrate the previously disadvantaged individuals. Protection mechanism strategies like import tariffs were relaxed; and emphasis was placed more on export promotions, improved service related industries, and investment elsewhere in Africa.

**2000s**

Government sought to reduce rising unemployment levels and reduce structural inequalities. The Department of Trade and Industry (DTI) introduced the Industrial Policy Action Plan (IPAP) which
mapped out industries that the government would focus on the promotion of sustainable growth and reduce unemployment levels within the country.

Focus was on developing rural areas and other previously underdeveloped regions, beneficiation in downstream industries, entrepreneurial development and sector strategies, (van Zyl, 2010).

**Graph 4.2 Growth of the South African economy**

![Growth of the South African economy](image)

*Source: World Bank, World Development Indicators 2009*

### 4.1.3 Brazil

Brazil has the largest economy in South America, the second largest in Latin America and is among the world’s fastest-growing economies. Along with China and India, Brazil is ranked among the nations with the highest predicted development rates in the next 25 years (Gouvea Raul, 2004).

Since the election of President Lula da Silva in 2002, the Brazilian government has been actively encouraging foreign investment to enhance and stimulate economic growth. Infrastructure is a vital component for any nation’s economic progress, and to this end the PAC program envisaged an investment in infrastructure of more than $250 billion from 2007 to 2010. The PAC program includes initiatives such as building airports and sea ports, repair of highways, development of energy projects in the north, and providing housing, water and sewage systems to assist the poorer Brazilian communities. The program also encompasses measures to improve the investment environment in the country. These initiatives will help to remove some of the current infrastructural bottlenecks plaguing the country and contribute to its economic development, (BNDES, [www.bndes.br.gov](http://www.bndes.br.gov)).
In its seventh progress report\textsuperscript{5} released in June 2009, 14% of the 2,446 projects monitored had been completed, 77% of the projects in the PAC were considered to have made "adequate" progress, 7% required attention, and only 2% were seen to be proceeding at a worrying pace. The report stated that 335 projects had been completed since the launch of the PAC in January 2007, representing BRL62.9 billion ($32.1 billion) of investment. This indicated that the PAC had achieved its goal to a large extent, as more than 90% of the projects had been completed or had made adequate progress.

Brazilians like South Africans are poorly educated, with an illiteracy rate of 17% (compared to 14% for South Africa) and high dropout rates. The national language of Brazil which is Portuguese and Brazilian’s English language skills which are poor on average may restrain long-term growth prospects for the country.

**Graph 4.3: Illiteracy rates**

![Illiteracy rates graph](image)

*Source: CIA factbook, illiteracy rates*

**Evolution of the economic landscape**

The period from the end of World War II to 1962 was a phase of intense import substitution industrialization strategy (ISI) and this strategy had a dramatic impact on the Brazilian economy, society, and business environment.

\textsuperscript{5} BNDES financial statements, 2009
During this period, the Brazilian economy evolved from an agrarian-based economy to a manufacturing services oriented economy. For instance the share of agricultural sector declined from 25% in the 1950s to less than 10% in the early 2000s (Gouvea R, Doing Business in Brazil- A strategic approach, 2004).

1980s
The Brazilian economy went through a period of hyperinflation which led to high interest rates. Political strife didn’t help the situation instead delayed crucial reforms. In time, high inflation rates became a palpable reason behind public sector stagnation; as a result, controlling inflation became government’s principle concern (Brazil, The economist Intelligence Unit Report, 2008).

These measures came to be known as ‘heterodox economic shocks’. The Cruzado Plan in 1986, the Bresser Plan in 1987 and the Summer Plan of 1989 were used to control the situation. The Cruzado Plan attempted to control the burgeoning inflation by freezing and readjusting wages, general prices, exchange rates, mortgage payments and rents and banning indexation completely. The other two plans, similarly, resulted in the freezing of prices and elimination of indexation. The Summer Plan, executed during the end of the decade, was limited to the reduction of hyperinflation. The plans were comprehensively successful in eliminating the menace of inflation (Obut, 1998).

In 1989, Brazil had its first democratic elections since 1964 and these led to drastic economic changes. The newly elected president, Fernando Collor de Mello, discontinued the ISI model and promoted market orientated reforms. A privatisation program now challenged the state led capitalism model. Trade and investment liberalization measures replaced the autarchic model established in the 1950s (Gouvea: Doing Business in Brazil- A strategic approach, 2004).

1990s
By 1993, the annual inflation rate had reached 2,708% and controlling the hyperinflationary process was becoming central to stabilizing the Brazilian economy. In 1994, the Real Plan which based on fiscal adjustment and an indexing system was introduced. A new currency, the Real was introduced; and the Real Plan succeeded in lowering inflation prices. By 1996, the inflation rates had fallen to 9.3% similar rates experienced in the 1950s (Gouvea: Doing Business in Brazil- A strategic approach, 2004).

Since 1992, growth rates have mostly been steady. This sustained growth is an outcome of prompt initiatives implemented first by President Cordoso during 1994–2002, and then by the incumbent President Lula after 2002.

2000s
The infrastructure sector grew significantly over this period owing to large scale private sector participation in both infrastructure development and maintenance. Compared to the world, during

6 Correction, please refer to point 4 on addendum.
2004–06, the Brazilian economy witnessed sound growth rates, which were a result of prudent fiscal policy implementation (Oliveira: The Brazilian Economy under Lula, 2007).

Table 4.3 Brazil growth rate vs. World Growth rate

<table>
<thead>
<tr>
<th>Year</th>
<th>Brazil</th>
<th>World</th>
</tr>
</thead>
<tbody>
<tr>
<td>1994</td>
<td>5.9</td>
<td>3.8</td>
</tr>
<tr>
<td>1995</td>
<td>4.2</td>
<td>3.6</td>
</tr>
<tr>
<td>1996</td>
<td>2.7</td>
<td>4.1</td>
</tr>
<tr>
<td>1997</td>
<td>3.3</td>
<td>4.2</td>
</tr>
<tr>
<td>1998</td>
<td>0.1</td>
<td>2.8</td>
</tr>
<tr>
<td>1999</td>
<td>0.8</td>
<td>3.7</td>
</tr>
<tr>
<td>2000</td>
<td>4.4</td>
<td>4.7</td>
</tr>
<tr>
<td>2001</td>
<td>1.3</td>
<td>2.4</td>
</tr>
<tr>
<td>2002</td>
<td>1.9</td>
<td>3.0</td>
</tr>
<tr>
<td>2003</td>
<td>0.5</td>
<td>4.0</td>
</tr>
<tr>
<td>2004</td>
<td>4.9</td>
<td>5.1</td>
</tr>
<tr>
<td>2005</td>
<td>2.3</td>
<td>4.3</td>
</tr>
</tbody>
</table>

(Source: CNI, April 2006)

President Lula proposed for a contraction in fiscal policies to bolster economic growth. The economy decelerated during the second half of 2005, but rebounded in 2006 after key export generating sectors like the service industry (telecommunications, energy generations, transportation and financial services) contributed impressively to the total exports of the country. The economy registered a growth rate of 3.7% in 2006, which went up to 5.3% in 2007 (The Economist Intelligence Unit limited, Country Profile-Brazil, 2007).

The country’s economy is tightly regulated compared to other emerging markets. However, trade liberalisation during the 1990s and a more proactive policy of export promotion resulted in strong growth of merchandise trade. Growth in export earnings was driven by expanding export market in Asia, Africa, the Middle East and Eastern Europe. Brazil strengthened its position by being an important supplier of soya beans and iron ore to China (The Economist Intelligence Unit limited, Country Profile-Brazil, 2007). The country’s growth rate increased in 2008 to reach 5.9%.

To date, Brazil has increasingly become a service orientated economy. Services accounted for 65.8% of GDP in 2007, while industry accounted for 28.7% and agriculture 5.5%. With its ample natural resources, Brazil has comparative advantages in agriculture and primary goods processing including iron ore and steel. The main agricultural commodities include soya beans, sugar, cocoa, meat and poultry (The Economist Intelligence Unit limited, Country Profile- Brazil, 2008).
Real gross domestic product by sector (% share of GDP)

<table>
<thead>
<tr>
<th></th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture</td>
<td>7.4</td>
<td>6.9</td>
<td>5.7</td>
<td>5.2</td>
<td>5.5</td>
</tr>
<tr>
<td>Industry</td>
<td>27.8</td>
<td>30.1</td>
<td>29.3</td>
<td>30.1</td>
<td>28.7</td>
</tr>
<tr>
<td>Services</td>
<td>64.8</td>
<td>63.0</td>
<td>65.0</td>
<td>64.7</td>
<td>65.8</td>
</tr>
</tbody>
</table>

*Source: Economist Intelligence Unit*

Graph 4.4 Evolution of the Brazilian economy

Source: World Bank, World Development Indicators 2009

### 4.2 ECONOMIC AND DEVELOPMENTAL PERFORMANCE

#### 4.2.1 South Africa

The South African economy grew by 3.8% per year between 1994 to 2008. While not outstanding this growth international averages, only lower income countries like China and India grew at a faster pace. South Africa ranked 22 out of 33 for growth amongst the middle income countries between 1994 to 2008 outranking Argentina, Mexico and the Czech Republic whilst lagging Chile, Malaysia and most of East European Countries, (WEF, Competitiveness Report, 2010).
The world wide economic downturn that started mid-2008 affected South Africa, with its GDP growth dropping below 3%, government income reducing by more than 10% and the government’s fiscal deficit climbing to more than 7%; which made it impossible for government to expand its core programs. The reduced income generation through the taxes by South African Receiver of Revenue Services (SARS), drop in the purchasing power index showing that consumers were not spending and massive losses of jobs especially in the resources and financial services sector; and the strengthening of the rand which impacted heavily on exports were among the contributors to the widening gap in the fiscal deficit.

**Graph 4.5 GDP and Growth rate of South Africa**

![Graph 4.5 GDP and Growth rate of South Africa](image)

*Source: International Monetary Fund, World Economic Outlook Database, October 2010*

**4.2.2 Brazil**

The economy registered a growth rate of 3.7% in 2006, which went up to 5.3% in 2007 and this was due to strong balance of trade figures. The global crisis of 2008 did not affect this economy as much as others mainly because the country’s economy is tightly regulated and it stuck with its orthodox macroeconomic policies. The country’s growth rate increased in 2008 to 5.9% due to tighter credit conditions and weaker demand for Brazilian exports; however, its GDP was expected to fall to around 2.5% in 2009 (The Economist Intelligence Unit limited, Country Profile- Brazil, 2009).
4.3 OVERVIEW OF THE BANKING INDUSTRY\textsuperscript{7}

Before comparing BNDES and the IDC it is important to draw comparisons and similarities the banking sectors where these two development financial institutions operate. This section will cover an overview of the structure of both the South African and Brazilian banking industries.

4.3.1 THE STRUCTURE OF THE SOUTH AFRICAN BANKING INDUSTRY

According to IMF, the South Africa’s financial system is fundamentally sound. The system is diversified and spans a broad range of activities that are supported by an elaborate legal and financial infrastructure and a generally effective regulatory framework as depicted by the table below (IMF, South Africa, July 2009).

\textsuperscript{7} Please refer to point 5 of the addendum
South Africa has a well developed, advanced and well diversified banking sector. The financial sector comprises a sophisticated banking sector, well-established capital markets, and an array of nonbank institutions, including insurance companies, pension funds, and collective investment schemes. This banking system is dominated by a few conglomerates with interlocking ownership and operations covering a broad range of activities. The insurance and pension sectors are large and well-developed. Capital markets are relatively advanced with significant activity in the derivatives, securitization, and hedge fund markets. Developmental Finance Institutions (DFIs) only have 4% of the banking sector as depicted by graph 4.6 below (SARB market share data, 2010).
Graph 4.6: Total SA Banking Sector %

Source: SARB data, March 2010

A. COMMERCIAL BANKS
Commercial banks are the largest segment of the financial sector, with assets representing some 120 percent of GDP. Four banks, the Amalgamated Bank of South Africa (ABSA), FirstRand Bank (FNB), Nedbank, and Standard Bank of South Africa (SBSA) account for almost 85 percent of total assets (graph 4.7) and have substantial international presence (Citi Bank Industry Report, 2010). Beyond a strong position in domestic markets, South African banks’ rapid expansion into African markets has been profitable and has contributed to their diversification.

Source: Citi Bank 18 August 2010
B. NATIONAL DFIs
The development finance institutions (DFIs) which are state-owned are part of the banking industry, with most receiving some form of financial support from the government. South Africa has a variety of DFIs which collectively assist in the implementation of the South African strategic objectives in terms of enhancing economic growth, augmenting employment opportunities; promoting industrial and infrastructural development; crowding-in investment, where they collaborate in certain investments; contributing to an improved distribution of wealth among different income groups and geographical regions; and encouraging economic transformation (van Zyl, 2010). The top 3 DFIs accounting for 92.5% of overall DFIs follow a self financing model, meaning they don’t get funds from government; instead they use their internal generated funds and borrow against their balance sheets where there are shortfalls.

**Graph 4.7 % Asset base for DFIs- South Africa**

The section below provides a brief overview of the DFIs within the South African economy.

**The Agricultural Land Bank (Land Bank)** was established in 1912 with a mandate of the development of agriculture, land reform and rural development. It offers financial services to both established and emerging farmers. Although the Land Bank has been largely self-financed, not receiving government support for many years and sourcing its funding requirements from capital markets, a measure of financial support from the State, in the form of guarantees and recapitalization, proved essential in recent times. This was because of institutional changes post 1997.
Since its inception, the Land Bank has undergone various phases of transformation:

Following the recommendations of the 1997 Strauss Commission's report, the Land Bank adopted a new mandate to bring on board farmers from previously marginalized groups to the mainstream of South Africa's agricultural sector, as well as contributing to rural development and stability, social upliftment and job creation.

**The Industrial Development Corporation (IDC)** was established in 1940 with the aim of developing South African industry through industrial development. IDC follows a self financing model and plays a key role in the development of industrial capacity within the South African economy. The history of the IDC and its funding mechanisms form parts of the core of this paper and will be covered in detail in the next sections.

**The Development Bank of South Africa (DBSA)** was established in 1983 and the main thrust lies in the provision of developmental funding for infrastructure projects that address the economic, social and environmental needs of communities in South Africa and in the rest of the SADC region. The DBSA follows a self financing model and supplements its flow of development funds by forming partnerships with the private and public sectors for projects that develop socio-economic infrastructure.

The following National DFIs were established post 1994 after the democratic dispensation.

**The National Empowerment Fund (NEF)** was established by the National Empowerment Fund Act No 105 of 1998 to promote and facilitate Black economic participation through the provision of financial and non-financial support to Black empowered enterprises. The NEF’s objectives also extend to promoting a culture of savings and investment among Black South Africans. The NEF provides funding to Black entrepreneurs for start-up and expansion companies, as well as for acquiring equity in existing White-owned businesses in line with the transformation objectives of the Government.

The NEF strives to address the following market failures/gaps:

- Lack of access to international markets;
- Poor quality of business plans;
- Limited management skills;
- Lower bargaining power; and
- Limited own-capital by Black entrepreneurs.

**The National Housing Finance Corporation (NHFC)** was established by the Department of Housing in 1996 with a mandate is to ensure that every South African with a regular source of income is able to access finance for purposes of acquiring and improving his/her home. The NHFC acts as a wholesale funder and risk-manager, facilitating access to housing finance for low and moderate income communities. The NHFC supports the Breaking New Ground (BNG) Strategy of the National Department of Human Settlements by:

- Making housing finance accessible and affordable for low- to middle-income earners;
- Assisting households through a range of financial instruments; and
• Facilitating the development of a viable and sustainable low- to middle-income housing finance market.

**Khula Enterprise Finance (Khula),** was established in 1996 as a part of an SMME funding initiative emanating from the White Paper on the National Strategy for the Development and Promotion of Small Business, which was adopted by Parliament in March 1995. Khula is an independent limited liability company that provides financing to the small-, micro- and medium-sized enterprise market through intermediaries as a wholesale financier. This DFI operates across the public and private sectors through a network of channels to supply much-needed funding to small business. Channels include South Africa’s leading commercial banks, other retail financing institutions, specialist funds and joint ventures.

Its primary aim is to bridge the “funding gap” in the SME market not addressed by commercial financial institutions. Recently, Khula has been exploring the possibility to provide direct lending to SMEs.

**The Independent Development Trust (IDT)** was established in 1990 as a fund specifically dedicated to alleviate chronic intergenerational poverty, especially among poor communities in the rural areas of South Africa. This agency offers programme management and development advisory services to government departments and other development partners for the eradication of poverty.

**The National Urban Reconstruction and Housing Agency (NURCHA)** is a section 21 company established in 1995 as a Reconstruction and Development Programme (RDP) Presidential Lead Project. Its primary function is to assist in releasing finance for low-cost housing through private financial institutions. NURCHA’s principal activity involves offering guarantees to commercial banks in order to encourage them to make bridging finance loans available to developers, specifically in instances where banks are not prepared to approve such loans without additional security.

**The Rural Housing Loan Fund (RHLF)** is a section 21 Company established in 1996 by the National Department of Housing of South Africa, with initial grant funding from the German development bank - the Kreditanstalt für Wiederaufbau (KfW). It was set up as a wholesale development finance institution with the mandate of enabling low income earners to access small loans that they could afford to repay. Borrowers use these loans to incrementally improve their housing conditions. As a wholesale finance institution, the RHLF facilitates the provision of micro-loans for housing through intermediary or retail finance lenders. These partners borrow funds from the RHLF and on-lend to individual borrowers throughout the rural areas of South Africa, including small towns and secondary cities.

**Micro Agricultural Finance Institutions of SA (MAFISA)** was established by the Department of Agriculture in May 2004. The provision of financial services by MAFISA is aimed at empowering micro-level producers, processors, the working poor, micro-entrepreneurs and emerging farmers who are active within the sector in rural and peri-urban areas; and able to embark on self-help initiatives so as to improve livelihoods; reduce poverty; develop viable businesses; and graduate into larger commercial businesses.

**The National Youth Development Agency (NYDA)** was formally established in June 2009 as a result of the merger between the National Youth Commission and the Umsobomvu Youth Fund. The NYDA’s
mandate includes the advancement of youth development through guidance and support initiatives across various sectors of society and spheres of government; embark on initiatives that seek to advance the economic development of young people; and develop and coordinate the implementation of the Integrated Youth Development Plan and Strategy for the country.

The Small Enterprise Development Agency (seda) was established at the end of 2004 through a merger of three organizations, namely, Ntsika Enterprise Promotion Agency, the National Manufacturing Advisory Centre (NAMAC) and the Community Public Private Partnership Programme (CPPPP). The primary focus of seda as a development agency is on micro-enterprises and very small enterprises, but the institution also provides assistance to SMEs and emerging entrepreneurs. Seda provides non-financial, enterprise development and support services through its network of outlets. Such services include business registration; business planning; access to markets; access to finance; support to cooperatives; small enterprise training and mentoring; and access to technology.

Over and above these there are provincial DFIs in each of the provinces within the country as depicted below.

*Source: DFIs in South Africa, IDC*
4.3.1 THE STRUCTURE OF THE BRAZILIAN BANKING INDUSTRY

The financial system in Brazil is the largest among the emerging markets. The country also has the largest financial system in South America. The banking and capital markets are diversified, dynamic, and competitive, despite the involvement of the state. Domestic banks are the leaders in the country, but foreign banks are gaining more presence. About 200 public and private commercial banks and many non-banking financial institutions have adopted international best practices. The insurance market, while growing, remains fairly small (The Economist Intelligence Unit limited, Country Profile - Brazil, 2009).

Table 4.5 Regulation in the financial sector - Brazil

![Diagram showing the structure of the Brazilian banking sector]

Source: Central Bank of Brazil (BCB)

Unlike the South African banking industry; the top ten banks include three state owned banks which control 39% of Brazil’s banking industry, four domestic owned banks control 34% of Brazil’s banking industry, three foreign owned banks which control 13% of Brazil’s banking industry and the rest is controlled by other banks in the country. Graph 4.8 below shows the percentage split in total assets in the banking sector.
Of the state owned banks Banco do Brasil (BB) is the largest and oldest bank in Brazil with a market share of 18%. BB is 61% owned by government and its focus is mainly on retail and agricultural markets. BNDES comes second with a market share of 12% and followed by Caixa with 9%. Caixa focuses on borrowing to low income groups of Brazil.

If one compares the banking industry of the two countries it is evident that the Brazilian state owned banks have a competitive advantage over the other banks. From literature readings, state owned banks in Brazil dominate the banking industry mainly because of the pressure they exact on private banks by
lending at lower rates. In South Africa however, this is reverse; the IDC is seen as the bank of last resort and the private banks offer competitive rates to clients. The differences and similarities will be discussed further in sections below as IDC and BNDES are discussed in detail.

5 INDUSTRIAL DEVELOPMENT CORPORATION (IDC)

5.1 HISTORY OF THE IDC
The IDC was established in 1940 with the aim of developing South African industry through the Industrial Development Corporation Act (No. 22 of 1940). The vision of the IDC is to be the primary source of commercially sustainable industrial development and innovation to the benefit of South Africa and the rest of the African continent. The IDC is a self-financing national development finance institution whose primary objectives are to contribute to the generation of balanced, sustainable economic growth in Africa and to the economic empowerment of the South African population, thereby promoting the economic prosperity of all citizens. The IDC achieves this by promoting entrepreneurship through the building of competitive industries and enterprises based on sound business principles. The IDC pays income tax at corporate rates and dividends to the shareholder.

IDC together with other Department of Trade and Industry (dti) DFIs report to the Department of Economic Development (EDD) and this structure places emphasis of centralised planning to ensure more efficiency in economic development. IDC’s role is that of guiding policy through its interaction with various policy makers; make inputs into accelerated Industrial Policy Action Plans (IPAP); support and provide inputs for development of South Africa’s growth path. In some circumstances IDC’s influence in guiding policy might be needed in areas beyond industrial policy, including among others rural development, trade etc. In terms of policy implementation, the IDC plays a pro-active approach in the development of projects with the highest impact in terms of driving implementation of policy.

IDC also plays an important role as an enabler by assisting entrepreneurs in developing and funding their businesses and in the process crowding in commercial financiers in the development of some businesses and industries that may be viable and desirable but unable to source funding from commercial sources. In these instances, IDC is increasingly setting conditionalities to its funding to ensure that development outcomes are achieved.

Since its establishment in 1940, the IDC has been adapting and expanding its strategy to the changing priorities of the South African Economy. In the 1940s the IDC focused on the development of the food and textiles sector. As the threat of isolation increased in the 1950s, IDC focused on the creation and development of petroleum (Sasol), energy (Eskom), wood processing (Sappi), mining and minerals (Iscor) and chemical beneficiation. In the 1970s-1980s IDC expanded its focus to include resource beneficiation and micro-electronics. In the 1990s as South Africa was integrated back to the global economy, IDC expanded its focus to include Tourism industries and ICT. With the introduction of IPAP 2000, IDC restructured to ensure that sectoral strategies will get priority; these were film, franchising, healthcare, education, financial services, transport, construction and alternative energy.
5.2 SOURCES OF FUNDS

The IDC is a self financing institution that funds its projects mainly through retained income, divestments of mature assets, borrowings in international and domestic debt capital markets. IDC borrows on the strength of its balance sheet with no government guarantees.

Currently the IDC uses the following funding methods:

- Bilateral Loans where domestic and international banks can lend to IDC on an individual basis;
- Syndicated Loans where various banks (both domestic and international) will lend to the IDC on a club basis;
- Development Finance Institution (DFI’s) loans where IDC borrows funds from other DFIs which have traditionally provided lending at concessionary terms and conditions.
- Private Placement where IDC has recently issued a bond to the Unemployment Insurance Fund (UIF) on a Private Placement basis, which is registered on the JSE. The intention is to for the UIF, in conjunction with IDC, contribute to the reduction of unemployment and contribute towards sustainable job creation and retention. The interest rate on the bond was a concessionary rate. This model is similar to that of BNDES which accesses funds from the Workers Assistance Fund at much lower long term rates to fund micro lenders.
- Short Term Banking Facilities where IDC borrows funds to meet the shorter term financing needs

Graph 5.2 IDC sources of funds

Source: IDC Annual Reports
5.3 APPLICATION OF FUNDS
IDC sources funds to invest in projects aligned to its mandate. Currently, IDC plans to disburse R100 billion in the next five years to projects aligned to its mandate that of contributing to the generation of balanced, sustainable economic growth in Africa and to the economic empowerment of the South African population, thereby promoting the economic prosperity of all citizens. The IDC will achieve this by promoting entrepreneurship through the building of competitive industries and enterprises based on sound business principles.

IDC funds are also utilized for addressing market failures and or gaps by supporting investments, which may otherwise not happen, in partnership with private sector companies.

Graph 5.2 below shows the application of funds over the past four financial years.

Graph 5.2 IDC application of funds

![Graph showing IDC application of funds over the past four financial years](source: IDC Annual Report 2009)

IDC investments are for development purposes, with the ideal investment being one that generates developmental as well as financial returns;

This entails taking a higher risk profile than commercial financiers in order to support the development of sectors and new entrepreneurs through:

- Diversifying the economy through supporting a range of sectors
- Encouraging the introduction and development of new industries and products
- Developing internationally competitive companies
- Supporting the establishment of greenfield developments

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8 IDC application of funds provided in percentage form for confidentiality purposes.
• Supporting expansions of existing businesses
• Facilitating the entry of new entrepreneurs and supporting their development
• Supporting the growth and development of small and medium businesses into competitive players
• Encouraging regional development by supporting companies with regional comparative advantages

6 THE BRAZILIAN ECONOMIC AND SOCIAL DEVELOPMENT BANK (BNDES)

6.1 HISTORY OF BNDES

The Brazilian Economic Development Bank (BNDE) was established on June 20, 1952, under Law 1628, as a government agency, with the aim of developing and carrying out national economic development policies. Subsequently, according to Law 5662, of June 21, 1971, BNDE was converted into a state-owned company under private law, which resulted in more flexibility to raise and invest funds, besides less political interference. The Brazilian Economic Development Bank (BNDE) was established on June 20, 1952, under Law 1628, as a government agency, with the aim of developing and carrying out national economic development policies. Subsequently, according to Law 5662, of June 21, 1971, BNDE was converted into a state-owned company under private law, which resulted in more flexibility to raise and invest funds, besides less political interference.

Initially, the BNDE invested heavily in infrastructure; however, in the 1960s, the cattle-raising and agricultural sector, as well as small and medium-sized Brazilian companies already had access to financing lines. At that time, the BNDE started operations into agreement with a network of accredited financial agents distributed all over Brazil.

The Bank played a fundamental role in Brazilian politics in replacing imports during the 1970s, culminating in the most complete industrial sector in Latin America. Investments in industrial segments that were still insignificant in Brazil began, including information technology and microelectronics.

In 1974, three subsidiaries were established to operate in the capitals market, aimed at expanding the types of capitalization for Brazilian companies. They merged in 1982 and became a new subsidiary named BNDESPAR. Integrating social concerns with the development policy in the beginning of the 1980s was made evident when the Bank changed its name to The Brazilian Economic and Social Development Bank (BNDES), in 1982.

During the 1980s, the Bank encouraged Brazilian companies to compete with imported products on the domestic market, as well as stimulating exports. In the 1990s, it was responsible for the administrative, financial and technical support of the Brazilian Privatization Program, assisting in the sale of large State-owned Brazilian companies, which began in 1991.

In the 1990s, the BNDES emphasized its role in regional decentralization through heavier investment in less developed regions in Brazil, as well as support for exports of micro, small and medium-sized companies. The environmental issue gained importance with the classification of the environmental risk of projects.
The Bank began to support the cultural sector in 1995 through investments in movie production and the preservation of Brazilian historical and artistic heritage. Investment in the cultural economy was systematized as of 2006, and financing was granted to all phases of the production chain.

In the 21st Century, the BNDES has confirmed its social nature, aiming at promoting local and regional development, social and environmental commitment and the innovation capacity in projects that request its support. These are the most pressing challenges in an ever changing and dynamic world.

The BNDES today is an active and modern institution, which continues to pioneer new boundaries. In 2009, the Bank inaugurated its one branch in South America (Montevideo) and a new subsidiary in Europe (London), in the pursuit of new alternatives to development in a globalized and interconnected world.

6.2 SOURCES OF FUNDS
BNDES sources funds from the domestic market and foreign markets. From the domestic market BNDES get funds from the Workers Assistance Funds (WAF), the PIS-PASEP fund, National Treasury and Others. Internationally, BNDES sources funds from other DFIs and government agencies like KfW, IDB, World Bank, NIBBIC and IDB; also funds are sourced from the market in a form of bonds, loans and structured notes. Up to 66% of funds come from institutional funding. Typical funding structure is depicted by graph 6.1 below.

Graph 6.1 Sources of funds BNDES

Source: BNDES, Gil, 2008
At least 40% of WAF is invested by BNDES. Workers Assistance Funds (WAF) was establish by the Brazilian Constitution of 1988, and is based on special tax from the public and private companies. These funds assist BNDES in playing a critical role in the Brazilian governments’ economic and social development strategy.

6.3 APPLICATION OF FUNDS

In the 1950s funds were spent on infrastructure projects mainly steel for the creation of energy and transport infrastructure. In the 1960s funds were invested in the creation and expansion of heavy industry and consumer goods; small and medium sized enterprises and technologic development. In the 1970s focus was on imports substitution basic inputs and capital goods. The 1980s started a period of change in Brazil; besides investment in energy and agri-business with the competitive integration at the end of the decade, Brazil initiated a period of huge transformation. At the end of the decade in the 1990s BNDES funded private infrastructure and export based projects. Other projects funded included urban and social development Because of that, BNDES is focused a new stage of Brazilian economy that is looking at innovation, productive structures or exports with social inclusion (BNDES, www.bndes.br.gov).

Going forward, BNDES’ mission is to foster the sustainable and competitive development of the Brazilian economy by promoting work opportunities and fostering the reduction of social and regional inequalities by 2014. Priority to achieve this mission is to ensure that funds are applied to innovation, PAC and energy, infrastructure projects; focus on expanding the equipment and inputs for agro-business, automotives, garement and shoe industries. Funds will also be placed in projects that will enhance productive capacity and increase capital goods.

Gráfico 6.2 Application of funds BNDES

Source: BNDES annual report
7 PERFORMANCE OF BNDES vs. IDC

Graph 7.1 BNDES vs. IDC performance

Source: IDC and BNDES annual reports

For a 10 year period observed from 1998 to 2008 the two banks were growing on average except for 2003. BNDES grew rapidly following the above average growth experienced by emerging markets especially the BRIC. The sustained growth first implemented by President Cardoso in 1994-2002, and his incumbent President Lula in 2002 saw the infrastructure sector growing significantly. BNDES together with private sector banks played a pivotal role in funding these developments. By 2008, the BNDES disbursements represented 14.2% of the Brazilian economy’s gross formation of fixed capital.

On the other hand the bull-run in the commodities sector saw the resources division growing rapidly and more funds were invested in this sector by the IDC.

In BNDES, about 60% of disbursements of 2008 went to the industry sector and 40% to infrastructure. Industry for BNDES includes mining, metal working, transport material, food and beverage, and chemicals. Infrastructure includes road transport, electric power, telecommunications and other transport.

For the IDC for the same period, 52% went into the resources sector, 19% industrial sector and 29% to services sector. Resources sector includes food and beverages, mining, venture capital and PPPs. The focus has been to encourage downstream beneficiation in the mining sector, increase participation in PPPs and invest in projects with high impact for example energy generating projects.

Industrial sector includes chemicals, wood and paper, metals and textiles. This has been the less funded sector over the years, however going forward IDC has to increase focus on industrial sectors to align with the South African strategy of creating sustainable jobs and the economy through the revised Industrial Policy Action Plan (IPAP) and the New Growth path (NGP).
Services sector includes tourism, franchising, healthcare, media, transportation and techno industries. The key strategic objective of the IDC is to create industrial capacity for the South African economy through alignment with IPAP and NGP and what this means is discontinuing funding to services industries that are not aligned with the government priorities.

Table 7.1 Funding split per sector at BNDES and IDC

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<tr>
<th></th>
<th>IDC</th>
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<tbody>
<tr>
<td></td>
<td>2006</td>
<td>2007</td>
<td>2008</td>
</tr>
<tr>
<td>Resources Sectors</td>
<td>44.30%</td>
<td>43.40%</td>
<td>52.20%</td>
</tr>
<tr>
<td>Industrial Sectors</td>
<td>21.70%</td>
<td>24.10%</td>
<td>19.00%</td>
</tr>
<tr>
<td>Services Sectors</td>
<td>34.00%</td>
<td>32.50%</td>
<td>28.80%</td>
</tr>
<tr>
<td>BNDES</td>
<td>2006</td>
<td>2007</td>
<td>2008</td>
</tr>
<tr>
<td>Industry</td>
<td>52.80%</td>
<td>40.70%</td>
<td>43.00%</td>
</tr>
<tr>
<td>Infrastructure</td>
<td>30.80%</td>
<td>39.50%</td>
<td>38.50%</td>
</tr>
<tr>
<td>Farming</td>
<td>6.60%</td>
<td>7.70%</td>
<td>6.20%</td>
</tr>
<tr>
<td>Trade/Services</td>
<td>9.70%</td>
<td>12.00%</td>
<td>12.30%</td>
</tr>
</tbody>
</table>

*Source: IDC and BNDES annual financial statements*

The table above illustrates the percentage split in funding for the IDC and BNDES. From this, it is evident that the different mandates and the difference in the structure of these economies results in the different funding allocations.

8 CAN THE IDC IMMULATE BNDES?

The response to the above question lies in that BNDES and IDC face similar challenges, in terms of ensuring sustained growth and development in the economies including job creation and alleviation of poverty in both countries. Major differences lie in the pace at which these countries are growing and the role and power given to each of these institutions by the governments. The larger role BNDES plays in the economy, and its aggressive expansion programs have proved to increase the GDP of Brazil. In the context of South Africa’s urgent need to reach a sustained higher growth path with significant employment generation, the IDC needs to consider ways to support increased private investment overall, as well as in targeted sectors as identified in the accelerated industrial policy action plan. Graph 8.1 below shows the growth for the past five years together with forecasted growth for South Africa and Brazil and compared to world growth.

Brazil’s DFIs have the biggest market share of 39% compared to 4% in South Africa which gives them a competitive advantage. Furthermore, these DFIs are able to put pressure by borrowing at lower rates compared to commercial banks. In the South African environment this is different; commercial banks

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9 Section 4
have majority stake of the banking industry and are able to borrow at rates lower than the DFIs and this gives them competitive advantage making DFIs banks of last resort. The role for BNDES vis-à-vis private financial institutions is more clearly defined than for the IDC, as the high short-term interest rates effectively mean there is little incentive for commercial banks to lend for fixed capital at the lower long-term rates. There needs to be an incentive mechanism to encourage commercial banks to borrow at lower rates for long term investments. The South African financial sector has, however, also not been responsive in financing fixed investment, particularly to medium and small enterprises. The IDC needs to evaluate the activities of the private financial sector, and the patterns of growth and investment, on a regular basis to identify the areas of need for development finance.

Graph 8.1 GDP growth for South Africa, Brazil and World

- BNDES has continued to develop specific programmes linked with the needs of the economy as did IDC in the past. IDC developed certain industries like Sasol in the petroleum industry and Iscor in the steel industry. Such programmes are linked to lower interest rates and more favourable terms (such as longer-term repayment periods and lower collateral). To be competitive and emulate BNDES, the IDC would have to adopt such programmes, where projects are linked to lower interest rates and long-term repayment periods. It must be noted however that the IDC has introduced these to a certain extent through schemes they provide for certain projects especially in the textiles industry. A proactive industrial development role for the IDC suggests translating the particular needs of different groups into specific programmes, including those linked to sectors targeted by government.

- A very strong emphasis in financing fixed investment is the building of linkages with industrial development through local content requirements by BNDES. In Brazil this is a key tool to develop the capital equipment sector, viewed as crucial to a strong industrial base. In South Africa, the capital equipment industry is weaker as a result of more than a decade of poor performance and
weak demand (itself a result of low fixed investment, including by SOEs). Careful attention needs to be paid to specifying expectations linked to the provision of finance. Going forward this will be possible as there is starting to be a clear plan of the relationship between the IDC’s strategies and the industrial policy goals of government through the Economic Development Ministry.

- Export finance plays a large, and growing, role for the BNDES. But, IDC’s export finance has declined over recent years. Here again it is important to note that BNDES links financing of major infrastructure projects on the South American continent with the development of Brazilian industry. While IDC plays a similar role, there is a need to re-evaluate the system of export financing in South Africa, across different agencies including ECIC of the DTI, and with particular reference to financing for exports to other African countries. The evaluation should assess whether the financing is competitive with those of other international agencies, and the extent to which linkages with South African production and employment need to be built in. In addition, the various guarantee arrangements operating in Brazil (for example, with Angola) and across projects in other South American countries provide useful examples of areas which could be further developed in South Africa.

- BNDES central role in industrial policy is widely recognised, is built on through its participation in developing policies and programmes, and is matched by BNDES representation at the highest levels of government. The IDC needs this role and has redeveloped it especially with the new Ministry of Economic Development. In the past, the IDC reported to the Department of Trade and Industry (DTI) and though there was interaction, it was not to appoint where IDC was central in industrial policy debate.

The challenge of emulating the BNDES implies a clear and proactive assertion of the IDC’s role as a key development agent in the economy. The articulation of the vision means the implementation of the new growth path as presented by the Minister of Economic Development; and the IDC aligning its strategies towards its implementation. This means shifting the growth path from one which has historically concentrated on large resource-based and capital-intensive enterprises to broader-based industrial development. Such a major reorientation of the economy is required to ensure the development of more labour-intensive downstream manufacturing oriented to both the local and international markets. Empowerment, and the development of small and medium enterprises, is part of the fundamental transformation of the structure of the economy.

The IDC is not the only institution in this process. However, it is the most important institution tasked with industrial development, and thus leadership in this field can be expected of it. This means the capacity to analyse the challenges and chart concrete steps. It also means leading through relationships with government and other institutions.

In addition, for the IDC to emulate BNDES, a forward-looking approach is required which seeks to anticipate challenges and opportunities. The potential benefits from the major increases in the capital expenditure on infrastructure by Transnet and Eskom are a good example. This challenges the IDC as a
development finance institution to constantly extend its information and knowledge base to be able to appraise future possibilities, rather than to follow the path of the past.

Added to this, is the deployment of resources outwards, to take on the leadership role in industrial development in partnership with government and other stakeholders, and to play a lead role in unlocking industrial development across the African continent.

The IDC’s role as the lead industrial development agency implies a central position in the economic transformation projects, including in policy formulation, implementation, and the strategic priorities which drive the IDC’s own financing decisions. Its position, at the heart of real economy activity and decision-making means it is well placed as a strategic resource of government – providing analysis to support co-ordinated interventions to move the economy as a whole. In addition, it is playing a crucial role in supporting the establishment of local development agencies and in advising other African governments on industrial policy.

9 CONCLUSION
The South African and Brazil governments both are focused on strategies that promote transformation and development of their economies including social and urban development. The result has been that each country drives a strategy that they believe will be sustainable and will deliver on their objectives. BNDES has been central in driving Brazil’s industrial policy plans. The answer to the question of IDC emulating BNDES is that IDC can and over the years it has followed the BNDES model. However, to clearly emulate BNDES; the IDC would have to be made central to the industrial policy of South Africa, the IDC would have to have to provide funding rates that are better than the banking industry, provide funding structures that are flexible and can compete with the banking industry and through its interaction with the Economic Development Ministry drive strategies that will unlock current and future bottlenecks in the economic value chain as discussed in this document.
10 REFERENCES


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11 ADDENDUM

This paper has been corrected taking into account both the external and internal examiner’s comments. Below are details of some of the changes that have been made as referenced in the footnotes:

1. Referencing has been corrected to be in-line with writing methods, and tables and graphs have been labelled accordingly.

2. Introduction to the research component has been rewritten to provide more meaning to the paragraph.

3. Pages 11 -12, Macro-economic policy are included to provide a brief background of macro-economic events that affected both Brazil and South Africa. This is meant to create a link why the DFIs (BNDES and IDC) have the mandates they have, which are discussed further on in the paper.

4. Correction on page 16; “hyperinflation led to high interest rates”.

5. Section 4.3, the discussion of the banking sector in both countries is discussed to provide the reader with an overview of the banking systems in both countries. The DFIs are discussed in brief to give the reader an overview of the different mandates these DFIs have in each country. A discussion on the Brazilian banking has been included which is something that was omitted in the previous discussion.

6. Section 7, the discussion of other DFIs has been taken out. The initial reason this was included was to provide a synopsis of what other DFIs around the world and what they do. As the examiner stated they fall out of the scope of this paper which is why they have been taken out.

7. A graph showing the sources of funds for the IDC has been included which provides a better understanding and ease of comparing the two banks. As stated in the footnote the IDC doesn’t get state funds except for the UIF fund which they manage and use for specific projects as mandated by the Department of Labor.