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**The Role of the BNDES in the Brazilian Development Financing – Contributions from  
the Paper “Towards a Legal Theory of Finance” of Katharina Pistor**

Alexandre Ramos Coelho<sup>1</sup>

São Paulo Law School of Fundação Getulio Vargas (FGV DIREITO SP)

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<sup>1</sup> Master Candidate in Law and Development at Direito GV.

**Abstract:** This paper aims to verify the main contributions and adjustments that the paper “Towards a Legal Theory of Finance” from Katharina Pistor may bring to the role of the Brazilian National Bank for Economic and Social Development (BNDES) in the Brazilian development financing. In order to do so, I work with two questions in this paper: (i) such theory presents elements which allow analyzing the role of the BNDES and from there, if it is required, adjustments can be made in the governance of the BNDES? and (ii) there are academics and scholars that, together with the theory, also contribute with the improvement of the BNDES role in the development of Brazil?

**Keywords:** BNDES; Katharina Pistor; law and development; Brazilian development.

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## 1 Introduction

The purpose of this work is to verify the main contributions and adjustments that the paper “Towards a Legal Theory of Finance” prepared by Katharina Pistor (hereinafter referred to as “Theory”) (2013) may bring to the role of the Brazilian National Bank for Economic and Social Development (BNDES) in the Brazilian development financing. In order to do so, the following questions and hypothesis will assist me in the preparation of this work:

(i) **Question 1:** the Theory presents elements which allow analyzing the role of the BNDES and from there, if it is required, adjustments can be made in the governance of the BNDES?

**Hypothesis 1:** I believe so. The Theory has at least four concepts that reinforce, under a different perspective, problems already identified through reading other authors, but which were not clearly exposed as they were in the Professor Katharina Pistor theory. Such elements shall be analyzed in detail during the work, but it is possible to name it already: **a)** the strict relationship between law and finances, being the law the creating element or structuring party of the modern financial market<sup>2</sup>; **b)** the resilience of the law; **c)** the necessary binding between market, state and, consequently, politics (hybrid system), to the extent that the government participates, supervises and regulates the markets, as well as operates as last resort guarantor to financial operations, also granting legitimacy to the agreements supporting said operations; **d)** the interdependence between domestic and international markets and its respective participants; and **e)** the inherent unpredictability, volatility and instability of the financial system.

(ii) **Question 2:** there are academics and scholars who may assist in the comprehension of the Theory, in order to understand the role of the BNDES and which, together with the Theory, make it possible to comment and improve the role of the BNDES in the development of Brazil?

**Hypothesis 2:** I believe so. Several authors and academics contribute to the reading of Professor Katharina Pistor texts and in the improvement of the BNDES. Among them Schapiro (2010), which refers to the importance of the mandate in the institutional improvement of the BNDES; Khan (2008) and the important role of technology and

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<sup>2</sup> For the purposes of this text, finances, financial system or financial market is a gender and it includes: capital markets, exchange market or foreign exchange market, credit market, public and private instruments market, sovereign debts market and derivatives market, as mentioned in Professor Katharina Pistor text.

technological innovation in the economic growth of a country; Lothian and Unger (2011), the concepts on cooperation between the state and market and on the role of the BNDES; Mashaw (2006), which refers to the accountability role in the government and in the market<sup>3</sup>; and Silveira (2010), which makes good suggestions related to the corporative governance of the companies invested by the BNDES or in which it is a stockholder to<sup>4</sup>.

Thus, in the next item, grounded on such questions I start to address the Theory, aiming to extract the concept, which may assist in the analysis of the BNDES as main financing vehicle in the Brazilian development. After, already based on such concepts or elements and also using the texts of the authors mentioned in question 2, I comment the main improvements which may be done in the legal and institutional structure of the BNDES. At last, I intend to conclude the work, confirming the hypothesis.

## **2 Brief Considerations on the Theory**

According to Professor Katharina Pistor, the Theory is inductive, because it was created from observations of the capital, credit, sovereign debt, currency and derivatives markets. Based on such observations she concludes that the financial markets, as well as financial intermediaries operating in it are constructions of the law, without which the market and its intermediaries would not exist. From such premises and other included in the text, she clarifies that the purpose of the Theory is to provide to the finances a new theoretical map of analysis, which counts on the relevant and intrinsic role of the law. According to her, the Theory intends to offer explanations about how the contemporary finances operate in times of abundance and also liquidity shortage. She complements clarifying that the current theories treat finances only at the moments in which the liquidity is abundant and do not take into consideration the instability inherent to the markets.

The Theory then is explained in details, according to the following elements, chosen due to the questions:

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<sup>3</sup> On an incompletely basis, the term accountability may mean the account rendering to someone or to an institution, whether a public or private one. It may mean that a bank, a company or a politician is liable for something and before someone or an institution, on such matter, on what way and on which premiums or sanctions the account rendering operates on. The term accountability shall not be translated to a specific expression in Brazilian Portuguese, and it shall be used in the text as Professor Mashaw makes use of it in his paper.

<sup>4</sup> Professor Alexandre di Miceli da Silveira gives some interesting suggestions for the improvement of the governance of the companies in which the Brazilian National Bank for Economic and Social Development ("BNDES") is a stockholder or financier.

**(i) law and finances – symbiotic relationship.** The finances or financial markets do not exist in the vacuum or outside the law, statutes, and regulatory rules. Quite on the contrary, the financial markets are formed, created by the law and by the rules. She mentions, as an example, the international over the counter market, which would not exist without the structuring and standardizing of agreements and legitimacy thereby with the respective jurisdictions, organized by the International Swaps and Derivatives Association (ISDA)<sup>5</sup>. The law lends the authority to the payment means; enables the government-owned or private controlled company of the markets through the law; and grants to the financial instruments the right to claim with the legal the rights included thereon. Summarizing, according to the Theory, there are no unregulated financial markets, only those regulated by the government or private sector;

**(ii) resilience of the law.** The resilience of the law may be defined as the probability that the legal liabilities or compliance with the agreements are or not maintained or confirmed in the future regardless of changes of the circumstances of the entering into an agreement. The resilience varies according to the parties dealing with the agreement. For instance, in the financial crisis of 2008, the United States Federal Reserve System financially redeemed a number of banks and financial institutions, which were not in conditions to comply with its liabilities before its counterparties. However, due to the systemic risks such institutions presented and its relationships with the United States authorities, they were redeemed. On the other hand, the borrowers, natural persons, which did not have financial conditions to pay its debts, lost its real estate to the banks due to mortgage agreements which were completely enforced by the financial institutions. At the top of the triangle, with the financial authorities, the law is resilient, at the bottom of the triangle, in the relationship borrower-bank, the agreements are complied literally according to its clauses, the law is considered not resilient on the basis;

**(iii) market and state – hybrid system.** The financial market is a hybrid one. It is formed by crossing the state and market, not being public either private but both. The financial market, as it currently is, would not be possible without the State. It is the result of the need of financial instruments to have the characteristic inherent thereto, which is the possibility of them to be enforceable; that the financial markets are structured on an hierarchically basis, so as to the top of the triangle are the financial authorities (for instance: Banco Central) or the state and at the bottom of the triangle are the financial intermediates

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<sup>5</sup> International Swaps and Derivatives Association – ISDA (<<http://www2.isda.org>>). Organization formed by the main international brokers and private banks, which trade daily trillions of Dollars in derivatives agreements.

and investors, for instance; and that the last resort, is that the state protects the financial system from self-destruction, redeeming, as the case may be, financial institutions presenting systemic risk, for example.

It is important to highlight that according to Professors Lothian and Unger (2011), the cooperation between the State and private companies, and between the very private companies during the Second World War, all coordinated by government-owned actions, encouraged the technological innovation of that country;

**(iv) interdependency of the domestic and international markets.** The financial markets are defined as an agreement connection network interconnecting the investors, intermediates and several jurisdictions of the international financial system. Such interdependency allows that the characteristics and demands of one market influence in other market with new rules and regulations; and

**(v) financial system instability.** The financial system is characterized by uncertainty and volatility or liquidity restriction, especially in times of financial crisis such as the one of 2008, in a way that the markets are not controllable and predictable according to the rules arising out upon the international financial crisis of 2008. On the contrary, the uncertainty on the future of domestic and international finances allied to the liquidity shortage causes instability proper of the current financial markets. The instability is not then an exception, but the rule of the markets. The law even contributes to the instability of the markets to the extent that it sets forth rules or builds products and contractual relationships between the participants not having escape routes or clauses allowing flexible constructions turned, for instance, to liquidity shortage situations.

### **3 BNDES – The Theory and Possible Improvements**

According to Rocca (2013), between 2002 and 2012, only about 33% of the total disbursements of the BNDES were destined to small and medium sized companies (R\$ 47.3 billion of a total of R\$ 141.8 billion), including the companies turned to technological innovation. On the other hand, the disbursements for big companies totalized R\$ 85,828.00. It is verified that the BNDES continues to finance big companies, as it did in the development period (60's and 70's). Although the role and form of operation of the bank has changed, it still has the focuses of financings of big companies. Corroborating with the researches of Rocca (2013), Lothian and Unger (2011) had also clarified that upon adopting policies related

to the national champions, for instance, the BNDES privileges certain companies in detriment of a majority. Furthermore, they mention that the companies which do get the loans or financings and are chosen to be the national champions are the companies which have a closest relationship to the state or with the managers of the bank (example of the law resilience concept, which is more resilient at the top of the triangle or closest to the authorities)<sup>6</sup>.

We ask: is that the role the government and the Brazilian society desire out of the BNDES? Is it possible to follow up the role exercised from the BNDES in the Brazilian economy? Do the government and the society have the control instruments of the financing processes and over the choices made by the bank? Is it possible to appraise the reasons leading the BNDES to continue with the same financing profile? Which are the legal solutions, which may encourage the increase, by the BNDES, of the financings to small and medium sized companies – including those of technology – if the society so desires?

According to Khan (2008), the economic growth of the less developed countries goes through the need to learn and acquire new knowledge and the development of new technologies. However, they face difficulties to organize processes allowing such learning and the advance in sectors of high value added, especially new technologies. Markets in development, including the most efficient, also have preventions to attract capital for research and development.

It is in such scenario that the BNDES, aiming at correcting a flaw of the Brazilian financial market<sup>7</sup> should act, financing the technological innovation and, consequently, the development of Brazil. The BNDES, differently of the private banks, may finance companies for long learning periods for obtainment of new technological knowledge and, and with that, encourage the industrial innovation. How to proceed then? In what way can the law act so the BNDES may have legal support and encouragement so as to its executives, for instance, may destine the financial funds to the small and medium sized companies dealing with the technological development?

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<sup>6</sup> According to Professor Katharina Pistor in her Theory: “[...] Second, actors will seek to position themselves strategically towards the apex of the domestic or global system where they are most likely to benefit from another lifeline. Individual actors may not have full control over their location in the system, but they can influence it by various means ranging from social or political ties to influencing the rulemaking process, to making themselves systemically important”.

<sup>7</sup> Concentration of the short-term bank financings turned to natural persons or, when legal entities, only short-term financings and with low leverage.

Although the Theory does not give obvious and direct solutions to this kind of Brazil's so specific and own problem, it gives us parameters or new principles on how the legal sketch turned to the improvement of the role of the BNDES should be made.

First, the relationship law and finances allow us to conclude that the law is a basic tool for institutional alterations required within the financial system. It is no longer an issue whether the law has or not an essential function in the financial system structuring. If the other theories addressed the law as something secondary, which was towed by finances, with the Theory, such old-fashioned perception ceases to exist.

Second, the financial market is unpredictable, volatile, there are liquidity shortages and it is, therefore, unstable, in a way that the legal structure to be construed shall count on flexibility, aiming at absorbing the instabilities proper of the market. There the concept of resilience of the law comes in which although it has to be resilient both at the base and at the top of the hierarchy of the financial system, its resilience can already be obtained upon input – at the top of the triangle or of the hierarchy – of a governmental authority which monitors, which play the role of manager of the new rules to be drawn.

Among the solutions fitting the characteristics of the Theory, there are the improvement of governance and transparency of the BNDES. To such effect, Schapiro (2010) contributes in the sense that it is possible to perfect the accountability, transparency and responsiveness mechanisms of the BNDES, setting forth proceedings similar to the ones adopted by the Brazilian monetary policy and which serves to monitor and turn Banco Central more responsive to the inflationary control policies. It is important that a proceeding grounded on administrative rules of the law lead the BNDES to answer to the Brazilian Federal Treasury Department, for instance and not to the Congress, what could make unfeasible alterations in the mandate of the BNDES which follow the industrial policies adopted by the government. In such case we have a system, which congregates resilience of the law, observing the hierarchy of the financial system and which, consequently, shall have conditions to meet institutionally the Brazilian industrial policy changes and the instability of the financial market.

However, the solution, although comprises the resilience of the law and the hybrid characteristics of the financial system (state-market), falls in the lack of accountability of the Brazilian government what may become a new rule of mandate and inefficient transparency<sup>8</sup>.

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<sup>8</sup> I ask if indeed a proceeding rule regulating the relationship Executive Power and the BNDES, even with the increase in the transparency and exposure of the acts and of the mandate of the BNDES, could it improve the operation thereof or would it only give legal legitimacy to political influence and strengthening of the rent-



The Professor Katharina Pistor already foresees this problem in her Theory. According to her, the construction of the financial system through the law leads us to the concept of resilience of the rules. Such concept, on its turn, due to bigger resilience of the law at the top of the pyramid (state/government authority), leads us to the economic policy of finances and politician's discretion (for instance: Brazilian Federal Treasury Department)<sup>9</sup>.

I understand that such problem can be solved through legal proceedings increasing, on their term, the transparency, and accountability<sup>10</sup> of the Brazilian Federal Treasury Department with respect to the role of the BNDES, for instance. Mashaw (2006) sets forth the basic rules in order to structure a good accountability<sup>11</sup> program. The institutional designer shall be the one who shall work in the answers to the matters: **(i) (who)** – Who shall answer? **(ii) (to whom)** – To whom shall answer it to? **(iii) (standards of appraisal)** – What are the appraisal standards of the answers? **(iv) (about what)** – On what shall the Brazilian Federal Treasury Department answer? **(v) (how)** – In what manner? **(vi) (rewards and sanctions)** – What are the rewards and sanctions related to the Brazilian Federal Treasury Department answers?

Further to the points brought above, we have that the interdependency concept between the domestic and international markets and its respective participants, provided for in the Theory, lead us to conclude that it is not enough to look at the BNDES nationally or even only to the domestic financial market. It is interesting to observe, for instance, the demands of the investors not residing or foreigners. It is possible to improve the volume and quality of the foreign investments in the country, having the BNDES as inducting agent of such investments? I believe so. In what way? Through improvement of the corporative governance of the companies receiving financing of the BNDES or those in which such bank is stockholder. According to Silveira (2010), in the operation of the bank as stockholder, it is

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seeking capitalism or crony capitalism we see today in the “national champions” policy. I argument also that the monetary policy, for instance, has always been attached to the ideology of the duty government.

<sup>9</sup> On her Theory, Professor Katharina Pistor clarifies that: “Unpacking the legal construction of finance thus leads us to the elasticity of law and from there to the political economy of finance. Where law is elastic decisions are not predetermined by legal rules but left to the discretion of “power wielders” (Grant and Keohane 2005). Power can thus be defined as the differential relation to law. **Where law is elastic power becomes salient. The critical questions are who exercises it, to whose benefit, how its exercise is legitimated and to whom the power wielders are held accountable**”. (our highlights).

<sup>10</sup> On her Theory, Professor Katharina Pistor highlights that: “Yet, as the Law-Finance Paradox suggests, strengthening commitment devices alone without reducing the systems’ structural vulnerability to crises can prove counterproductive. Legislatures have also sought to limit the powers of regulators and central banks by subjecting bailout decisions to political control (Gadinis 2012). **Politicians have recognized that discretionary decision-making is an exercise of power that may require political accountability**”. (our highlights).

<sup>11</sup> According to Professor Mashaw: “Indeed, by recognizing that accountability’s basic structure is an answer to six common questions, and by recognizing that we have choices across differing types of accountability regimes, we can make some progress on the design of instructions that satisfy our accountability demands”.

possible to follow the examples of the International Finance Corporation (IFC), in which it binds the entry as partner investor in companies structuring projects or project finance, for instance, to a commitment purpose of the company invested on of improving its governance practices. With such improvement in the operation of the BNDES and consequent development of the corporative governance, the quality of the capital (not merely speculative) and the number of foreign investors in companies of good corporative governance may increase since the not residing / foreign investors prefer to invest in companies with good governance practices. Such improvement was structured and remembered due to another principle included in the Theory, that is, the interdependency markets principle and of the domestic and international participants in the financial system.

#### 4 Conclusion

The Theory may help in many other institutes of the Brazilian financial market. For instance, in investment funds playing a fundamental role in the saving of funds intended to investments in the Brazilian and foreign financial market. In what way? Working with the concept of resilience of the law. Example, the flexibility on the concentration of assets in a certain portfolio, according to the type of investment fund (ex.: stocks or fixed income funds). At last, such shall be detailed, but it states the power of the Theory.

Finally, I can conclude that the hypothesis were tested and confirmed according to item 3 above.

Those were my considerations.

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