

ACCESS TO CREDIT TO FIGHT POVERTY IN BRAZIL

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Abstract

Public policies for credit access have been an important tool to fight poverty and promote social inclusion in Brazil. In the government of President Luis Inácio Lula da Silva, the concept of credit access has been expanded beyond the production-oriented credit to now include a credit for consumption and for financial inclusion of individuals at the bottom of the social pyramid. These changes are described and analyzed in this paper.

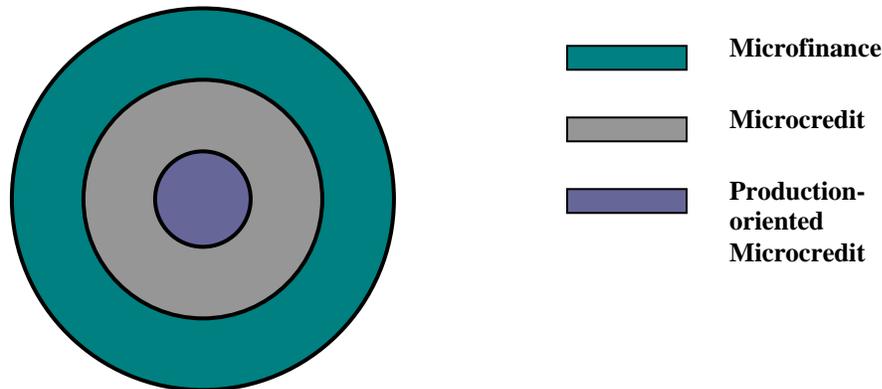
KEY WORDS: Microcredit, microfinance, credit access, local development, poverty

MICROFINANCE AND MICROCREDIT: FUNDAMENTALS

There is no consensus in the literature on the definition of microfinance and microcredit. Usually, microfinance is defined as the provision of financial services (credit products, credit for consumption, savings, insurance, etc.) for low-income people who do not normally have access to these services through the traditional financial system [BNDES, 2002; CGAP, 2007]. Bouman [1989] considers microfinance as small loans, with installments paid in the short-term that are mainly intended for low-income individuals who have very few assets to offer as collateral. Microcredit, in contrast, can be defined as all financial services offered to small-sized businesses, excluding the credit for consumption. The Microcredit Summit (2007) defined microcredit as small loans to very poor individuals so that the poor can be self-employed and thereby generate income for themselves and their families.

Broadly speaking, the production-oriented microcredit is a loan given to micro and small businesses in either the formal and informal economy. This loan is intended for small-sized businesses, managed by low-income people, and it is not intended to finance consumption [Alves & Soares, 2006; BNDES, 2002]. Access to this credit facility helps small businesses and, in turn, leads to higher household consumption through the generation of income. A diagram representing the structure of microfinance in Brazil is shown in Figure 1.

**FIGURE 1
STRUCTURE OF MICROFINANCE IN BRAZIL**



Source: Alves & Soares, 2006, page 29.

MICROFINANCE IN THE GOVERNMENT OF LUIS INÁCIO LULA DA SILVA

According to Barone [2008], the first term of President Luiz Inácio Lula da Silva (2003-2006) represented a break-up of the political model prevailing in Brazil during the past 20 years. In 2003 a new team of policymakers chose to keep the previous government's economic policy. However, the concept of credit access was substantially redefined to include the lowest-income populations in Brazil (i.e., the bottom of the social pyramid). This redefinition led, in turn, to the granting of credit indiscriminately for consumption or production by the Brazilian financial system. Public banks, such as *Caixa Econômica Federal* (through the *CAIXA AQUÍ*) and *Banco do Brasil* (through the *Banco Popular do Brasil*), played a key role in this process by operating large networks of points-of-sale in bakeries, pharmacies and markets.

The Lula da Silva government concept of "microcredit" was to expand credits of small amounts, production-oriented or not, so as to generate business income. This contrasted greatly with the previous eight years of Fernando Henrique Cardoso's government in which microcredit was seen as only a production-oriented credit.

Issued in June 2003, the "Microcredit Package" was one of the most important actions intended to expand the reach of financial services to low-income Brazilians. This package had three main foundations: (1) the increased use of simplified accounts (financial inclusion); (2) the expansion of available loan pools by reallocating a portion of the funds that the banks were required to pay on demand deposits; and (3) the establishment of credit unions.

FINANCIAL INCLUSION

While Brazil still has a significant number of people without access to bank accounts, the number of such accounts has grown more than the population. Between 2001 and 2007, banks recorded a 57.5% increase in the number of bank accounts. Bank accounts increased from 43.3 million to 62.8 million during this time frame. In the same period, the number of savings accounts grew 39%, from 51.2 million to 71.2 million (see Table 1 below) [ALVES & MARQUES, 2006].

TABLE 1
ACCESS TO BANK ACCOUNTS AND SIMPLIFIED SAVINGS ACCOUNTS
(AMOUNT IN MILLION)
BRAZIL - 2001-2007

Type	Period						
	2001	2002	2003	2004	2005	2006	2007
Bank accounts	43,3	45,6	45,9	50,4	53,7	58,3	62,8
Savings accounts	51,2	58,2	62,4	67,9	70,8	71,3	71,2

Source: Developed by the author, based on data from the Central Bank of Brazil (2008).

Table 1 includes individuals from all social classes who had one or more accounts in their name and who also may have had simplified accounts. Research conducted by the International Labor Organization (ILO) and published in 2002, along with the findings of Mezzera & Guimaraes [2003], pointed out that even micro and small entrepreneurs may have had more than one bank account in different banks.

The expansion of bank accounts highlighted in Table 1 can be, in part, explained by expansion of simplified bank accounts. According to Alves & Soares [2006, p. 76], the main characteristics of simplified bank accounts, which distinguish them from regular demand deposit accounts, are:

- Individuals need to present only their identity card and a registration from the Brazilian Registry of Individual Taxpayers (CPF) to open this account;
- The maximum monthly balance in the account must be R\$ 1,000.00 (US\$ 435.00) per month; and
- Only individuals without demand deposits in any other Brazilian financial institutions can hold this account.

Simplified bank accounts are handled primarily by means of magnetic cards. In exceptional cases, the use of single checks is allowed upon request for withdrawals. By-and-large, simplified bank accounts are low cost and generate low returns for the Brazilian Financial System.

MICROCREDIT FOR CONSUMER AND PRODUCTION-ORIENTED MICROCREDIT

In 2003, Resolution 3.109 of July 24 was issued to enact the Law 10.735. This provision allowed for the application of two percent of demand deposits in commercial banks, including *Caixa Econômica Federal* and credit unions, to be used for microcredit loans. Previously, the law required banks to withhold two percent of their total deposits as their reserve requirement (i.e., the share of their deposits that must be placed interest-free in the Central Bank). The potential beneficiaries of this change were:

- Low-income individuals that held special deposit accounts established by Resolution 3.104 of June 25, 2003, or holders of other deposit accounts, which together with other investments kept in the financial institution, had a monthly average balance of less than R\$ 1,000.00 (US\$ 435.00);
- People qualified under Article Three, Item I, of Complementary Law 111 of July 6, 2001, which provided funds to fight and eradicate poverty; and
- Individuals or micro businesses (legal entities) that were able to contract transactions with credit entities to support micro businesses (SCMs) under the conditions set forth in Resolution 2.874 of July 26, 2001.

These transactions satisfy the following financial parameters:

- Effective interest rates could not exceed two percent per month;
- The credit amount could not exceed R\$ 600.00 (US\$ 261.00) for individuals and R\$ 1,000.00 (US\$ 435.00) for micro businesses;
- The maximum value for the credit-opening fee could not exceed two percent for individuals and four percent of the amount of credit granted to all beneficiaries; and
- The transaction period could not be less than 120 days. A smaller period was allowed provided that the credit opening fee was proportionately reduced.

Alves & Soares [2006] emphasize that maximum credit amounts per client were set to optimize the number of beneficiaries vis-à-vis the volume of funds that could be allocated to credit transactions. The level of income and economic capacity of the target audience was also taken into account. By setting such amounts, it was intended that the scope of these transactions would produce positive impacts on economic activities, thus helping to increase employment and income.

This Law embodied a shift in policy from the earlier Cardoso government's focus on prioritizing production-oriented credit as a mechanism for generating jobs and income for low-income entrepreneurs. The Lula da Silva government's policy was to substantially increase access to low-cost credit. Access to low-cost credit significantly encourages consumption and, in turn, generates demand in the economy to boost employment and income. It should be noted, though, that the Lula da Silva government's focus was not necessarily on the development of micro and small companies.

CONSIGNED CREDIT

Another popular type of credit encouraged by the Lula da Silva government was consigned credit. Authorized by Law No. 10.820, published in the Federal Official Gazette in December 2003, consigned credit repays loans by directly deducting a portion of the loan from an individual's salary or retirement/pension fund disbursement. Thus, consigned credit is offered only to formally contracted employees and retirees/pensioners of the Brazilian Institute of Social Security (INSS). For retirees and pensioners, the Brazilian Institute of Social Security guarantees the loan. For banks to be eligible to offer this credit arrangement, they must sign an agreement with the Social Security Institute. In May 2006, there were 31 banks and financial institutions accredited. For working and salaried employees, their loan collateral comes from the payroll of the private companies, city halls or state governments in which they work. Businesses and governmental agencies are free to enter into agreement with banks wishing to grant consigned credit.

Misuse of funds is the most common problem resulting from this type of loan. While misused funds are always a serious problem, the consequence of high indebtedness is magnified for low-income individuals. Aiming to minimize this problem, the federal government set a ceiling on indebtedness of 30% of the salary, retirement or pension income of the borrower. This limit also includes the credit card limit provided by some financial institutions. The maximum period to settle the debt is 72 months.

One factor that restricts consigned credit is that it is only given to formally contracted employees (retired individuals, pensioners, civil servants and private employees under a formal employment agreement); it is not given to individuals who are informally employed. In contrast, production-oriented microcredit does not make any distinction between formally and informally contracted individuals. Consequently, production-oriented microcredit tends to benefit the very individuals who are excluded from the formal economy, increasing its inclusive socioeconomic aspect.

BRAZILIAN PROGRAM FOR PRODUCTION-ORIENTED MICROCREDIT

The most recent institutional change in the Brazilian microfinance sector is the creation of the Brazilian Program for Production-Oriented Microcredit (PNMPO), through the enactment of Law 11.110 on April 25, 2005. PNMPO had three goals: (1) To encourage income generation and employment in micro-enterprises; (2) to provide resources for productive microcredit use; and (3) to provide technical support to financial institutions that make these loans available. Goal three's aim is to strengthen the range of services these financial institutions provide to micro-enterprises. PNMPO is coordinated and implemented through the Ministry of Labor and Employment and includes only institutions that are allowed to work with microcredit (OSCIPs - Civil Society Organization of Public Interest - and SCMs) and institutions empowered to work with other financial transactions (small-sized credit unions and financial institutions). In practice, these institutions play the role of facilitators of production-oriented institutions, banks and other entities dealing with public funds. Additionally, they support, encourage, disseminate and structure the microfinance sector. These institutions also overlap with the duties performed by Banco Nacional de Desenvolvimento Econômico e Social (BNDES), thereby sharing efforts. Table 2 shows the institutions registered in the program.

TABLE 2
MICROFINANCE INSTITUTIONS UNDER THE PNMPO,
CLASSIFIED INTO REGIONS. BRAZIL - MAY/2007

Brazilian Region	OSCIP	SCM	IFO	Credit Unions
North	6	0	1	1
Northeast^(a)	25	1	1	17
Southeast	27	13	1	12
South	34	2	0	81
Center-West	5	0	0	4
Brazil	97	16	3	115

Source: http://www.mte.gov.br/pnmpto/conteudo/instituicoes_habilitadas/default.asp.

^(a) Includes the Program CrediAmigo from Banco do Nordeste.

As of May 2007, the program qualified 231 institutions, including OSCIPs, SCMs, financial institutions (IFOs) and small-size credit unions. Financial institutions, such as ABN Amro through the Real Microfinance and Unibanco with Microinves, are the newest organizations in the microfinance market that offer production-oriented microcredit.

CONCLUSIONS

Significant work still needs to be done in terms of production-oriented credit, microcredit, consumption-oriented credit and financial inclusion in Brazil. Looking at microcredit only, the results are disappointing. Although there has been considerable growth in the number of financial institutions operating in the post-Real phase, these institutions serve only one percent of the demand as estimated by the ILO [Darcy & Soares, 2004]. More than half this number is under the responsibility of the Program CrediAmigo of Banco do Nordeste. This may explain the government's policy to promote financial inclusion and scale up the offer of credit through traditional financial institutions (two percent of compulsory payments on demand deposits).

Independent of the strategy adopted by the federal government, policy makers and society-at-large have understood recently that the war against poverty will not be won with paternalistic, patronage-based and cronyism-based actions, which are, unfortunately, an historical legacy of Brazilian society in the twentieth century. Poverty *can* be successfully fought with universal strategies that increase local development and inclusion through sustainable increases in individual income.

Public policies geared towards social inclusion and poverty eradication must be understood by the target audience, itself, which includes low-income individuals, the informally contracted, the low literate and those who survive by performing subsistence activities. As such, the concept of the family budget (a type of production based on the family workforce) should be reviewed and used to promote access to credit, financial inclusion and development.

The inclusion of these target audiences does not expand personal credit and consumption-oriented credit, as was the hope of Luis Inácio Lula da Silva's government. From a Keynesian perspective, access to consumption-oriented credit encourages people to consume; it stimulates demand for goods and services that consequently require more production and investment from firms, thereby creating new jobs. However, this type of credit will not generate jobs for low-income individuals because, as often noted, "low income" frequently equals "low literate." Low literate individuals have to overcome significant challenges in finding and maintaining work. Thus, if low income individuals are to be helped by such public actions, then integrated production-oriented credit policies, supported with training and technical assistance, must be developed.

Production-oriented microcredit will succeed in Brazil only if the microfinance sector is reorganized. Brazil needs, for example, an institution to coordinate the policies applied to different entities operating in the microfinance sector (OSCIPs, SCMs, NGOs, IFOs, credit unions, banks). This coordinating institution could be completely independent and empowered to act on its own, or it could act in a shared way with others in the industry. What is not in doubt is the need to create a coordinating institution for the entire microfinance system.

Once created, the institution would have a mandate to: (1) develop clearer rules for the microfinance industry; (2) modernize credit methodologies, thereby allowing production-oriented credit to be offered to a wider range of classes; and (3) create a common database, shared by all microfinance institutions, that could accurately assess changes in credit access. Currently, the Brazilian government is unable to accurately state the number of microfinance institutions in the country. Thus, given this lack of information, it is almost impossible to design any effective credit policy for base of the pyramid consumers. Significant work still faces Brazil to achieve its goals of social inclusiveness. It is hard work well worth taking.

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