

**FINANCIAL MECHANISMS THAT PROVIDE INCENTIVES FOR MICRO AND SMALL
BUSINESSES IN BRAZIL**

LUIZ HENRIQUE DE BARROS

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**Paper presented at the Institute of
Brazilian Issues**

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“Nothing is more social than helping small
businesses maintain and generate new
employment”

Cláudio Pituco

Manager of the Caixa Econômica Federal¹

¹ “**Nada é mais social do que ajudar as pequenas empresas a manter e gerar novos empregos**” Claudio Pituco, Gerente da Caixa Econômica Federal.

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²a Brazilian federal bank

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Course undertaken with financial
assistance from the Caixa Econômica
Federal ³

³ Curso realizado com apoio financeiro da Caixa Econômica Federal

INTRODUCTION

Micro, Small, and Medium Sized Businesses (MPME) have gained elevated importance within Brazilian economic activities; they are fundamental to the generation and maintenance of employment and income. They constitute the base of productivity, given that they provide products and services.

Data provided by the Brazilian Service for the Assistance of Micro and Small Businesses (SEBRAE) shows that in 2002, MPME were responsible for 99% of formal employment, 57% of total employment, and 26% of all salaries.

The necessity of providing incentives for MPME growth, as with the insertion of new companies into the market, has stimulated the Brazilian Government to develop incentive mechanisms from a broad variety of sources.

New laws were edited and bureaucratic proceedings revisited due to an initiative that was spearheaded by the Federal as well as by the State and Municipal governments. These laws are actions that include such initiatives as the creation of special tributary regimes or the optimization of opening proceedings and the regularization of businesses.

MPME confront a wide variety of difficulties in business activities. Access to credit, an input for any productive activity, is still a challenge to this market.

In another study realized by SEBRAE in August of 2004 and titled "Conditional Factors and Mortality Taxes of Companies in Brazil,"⁴ among the questions raised, subjects related to financial activity appeared to be the principle impediments to business activities.

The lack of working capital, financial problems, and a lack of bank credit were considered to be the causes of business failure by 42%, 21%, and 14% respectively, of those interviewed.

⁴ "Fatores Condicionantes e Taxa de Mortalidade de Empresas no Brasil"

Despite the challenges confronting the efforts of micro and small businesses to survive, such as the entrepreneurial capacity of the businessmen and the qualification of employees, among others, the macroeconomic context of Brazil has offered minimal stimulation for the businessmen and women of Brazil.

This study attempts to demonstrate some of the solutions discovered by the Brazilian State to confront the challenge of generating and maintaining small undertakings, specifically with regard to the financial side and aspects such as the efficiency and sustainability of existing mechanisms.

MACROECONOMIC CONTEXT

In 1994 Brazil began the long and arduous process of economic stabilization. The Real Plan introduced diverse mechanisms to combat inflation. One that deserves particular mention is the intelligent and consistent monetary policy.

Some measures of utmost importance were initially adopted, among which the following deserve particular mention:

- Institution of the Singular Value of the Real (URV) - after which substituted by the new currency, the Real;
- Creation of the Advisory of Monetary Policy (COPOM)⁵ - on June 20, 1996, with the objective of establishing parameters for the monetary policy;
- Effective control of the currency.

However, the process of controlling inflation requires other fiscal measures, which threaten the effects of stabilization on the interest rate practiced currently in the country.

Economic models demonstrate the affects of a lack of fiscal adjustment in the interest rates practiced and verify that elevated public spending results in a need to maintain high interest rates.

The best form of lowering interest rates and, correspondingly, stimulating investment and growth, is to increase domestic savings. Taking into consideration the equation below, which results from the income-expenditure identity, one can observe that growth in investment can stem from two actions related to savings such as:

- decreasing consumption
- cutting public spending

$$Y = C + I + G + NX$$

⁵ Conselho de Política Monetária

Y = GDP

C = Consumption

I = Investment

G = Public Spending

NX = Relations with external markets

Although it is theoretically possible to encourage decreased consumption, the increase in domestic savings would end up being a direct result of a cut in public spending.

Throughout the process of stabilization, Brazil has undertaken a serious fiscal effort, be it empowering fiscal and collection entities, or with the implementation of legislation such as the Law of Fiscal Responsibility (Complementary Law number 101, May 4, 2000) and the Reform of Social Security (Constitutional Amendment number 41, December 19, 2003)⁶.

The results of this effort, although already perceivable, still require a number of years to reach levels more appropriate to the long term maintenance of interest rates that are less damaging than currently used rates.

Graphic I demonstrates the trends in basic interest rates used by the Central Bank of Brazil with regard to the buying and selling operations of government bonds registered to the Liquidation and Custodial Service (SELIC)⁷.

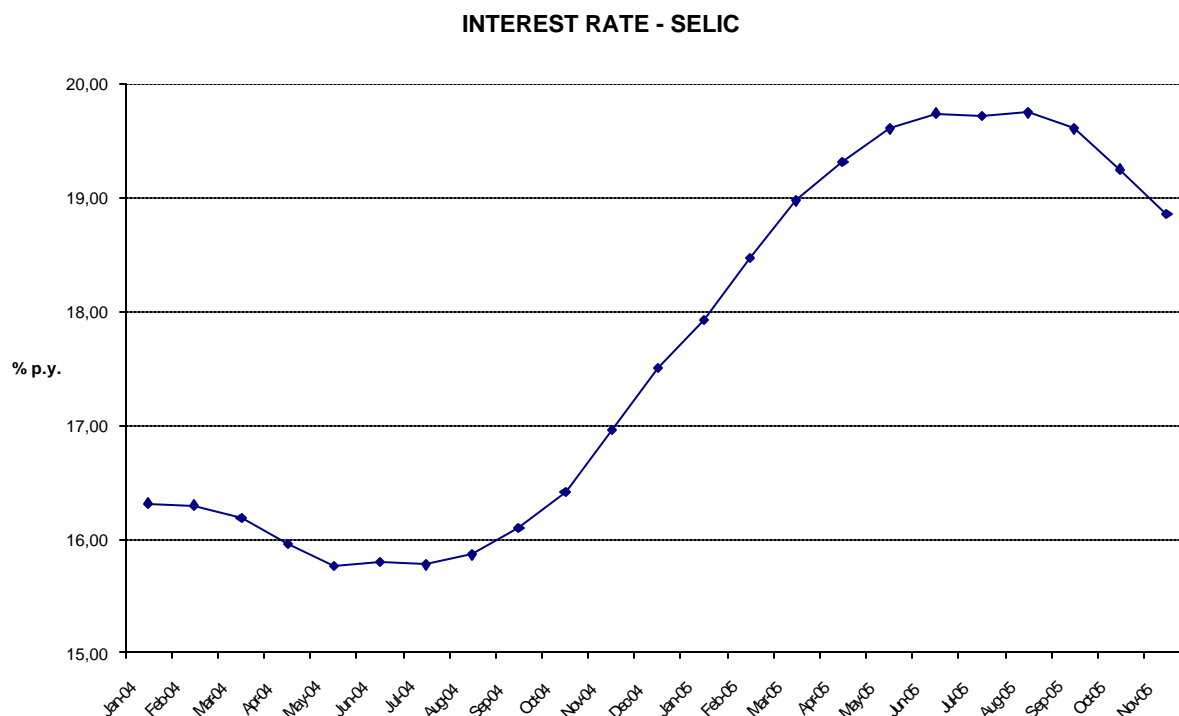
Some interesting conclusions follow from this graphic. In the past two years, as well as in previous years, Brazil has confronted the serious challenge of achieving an interest rate in the single digits.

The dilemma for the entrepreneur resides in the opportunity cost represented by the interest rate practiced in the financial market. There exists an economic cost represented by the option of investing in capital goods as the inverse of simply relocating resources into the financial market.

⁶ Lei de Responsabilidade Fiscal (Lei Complementar nr 101, de 04 de maio de 2000) e a Reforma da Previdência (Emenda Constitucional nr 41, de 19 de dezembro de 2003)

⁷ Serviço de Liquidação e Custódia – SELIC

GRAPHIC I



Source: Banco Central do Brasil⁸

By opting to act in the market as a businessman, the investor passes over the opportunity to acquire government bonds and receive 16% per year in interest without the apparent risk of default.

It is a misconception to consider that government bonds are fully without risk. However, our understanding is sufficient to herein consider that they are assets with very low risk.

The businessman and woman must balance the attractive payoff of assets with low risk against the possibility of investing in a market where risks are involved. Opening a micro or small business can be considered a decision in favor of a risky asset.

The above dilemma demonstrates a short term macroeconomic scenario that is not favorable to investment and growth.

⁸ Central Bank of Brazil

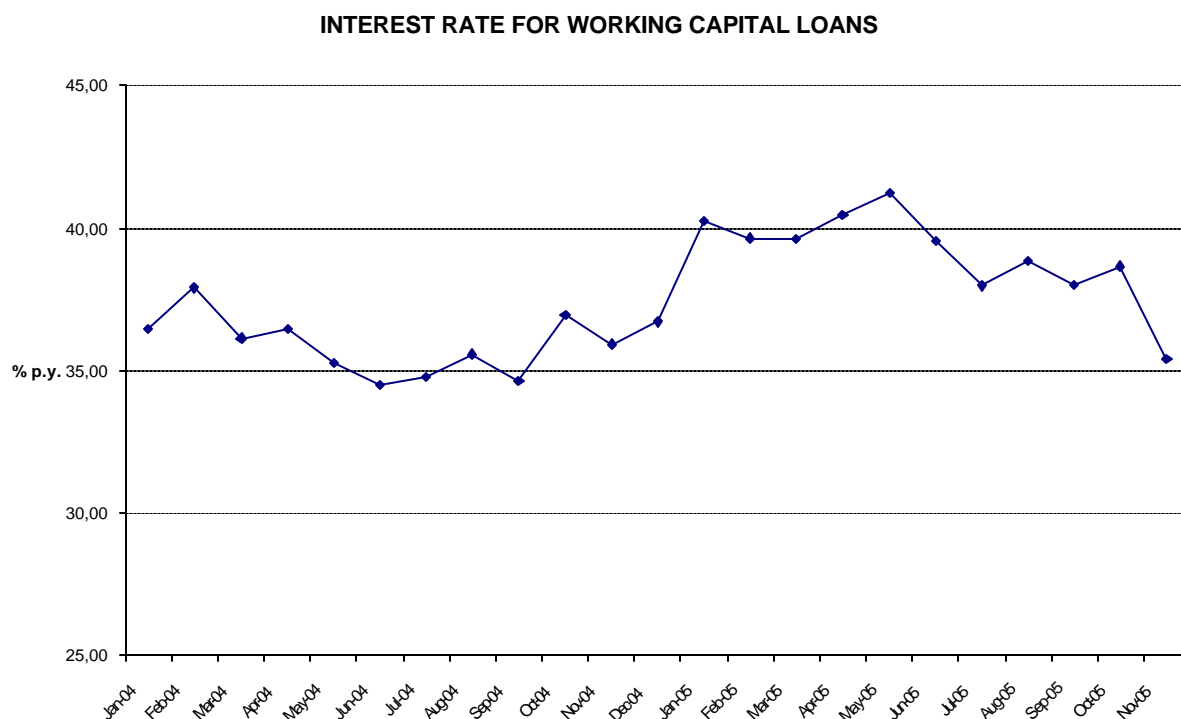
The SELIC Rate and the Credit Market in Brazil

The Basic Interest Rate, the SELIC⁹, is the foundation of the process of the formation of price in the credit market. What benefit could a financial agent hope to gain by operating with clients that represent risk if they could opt to lend to the Brazilian Government and receive an interest rate on the order of 16% per year?

The response to this question is clearly expressed by the interest rates in the countries' actual loans.

Graphic II demonstrates the variability of interest rates for working capital loans beginning in January 2004.

GRAPHIC II



Source: Banco Central do Brasil¹⁰

⁹ Taxa Básica de Juros – SELIC

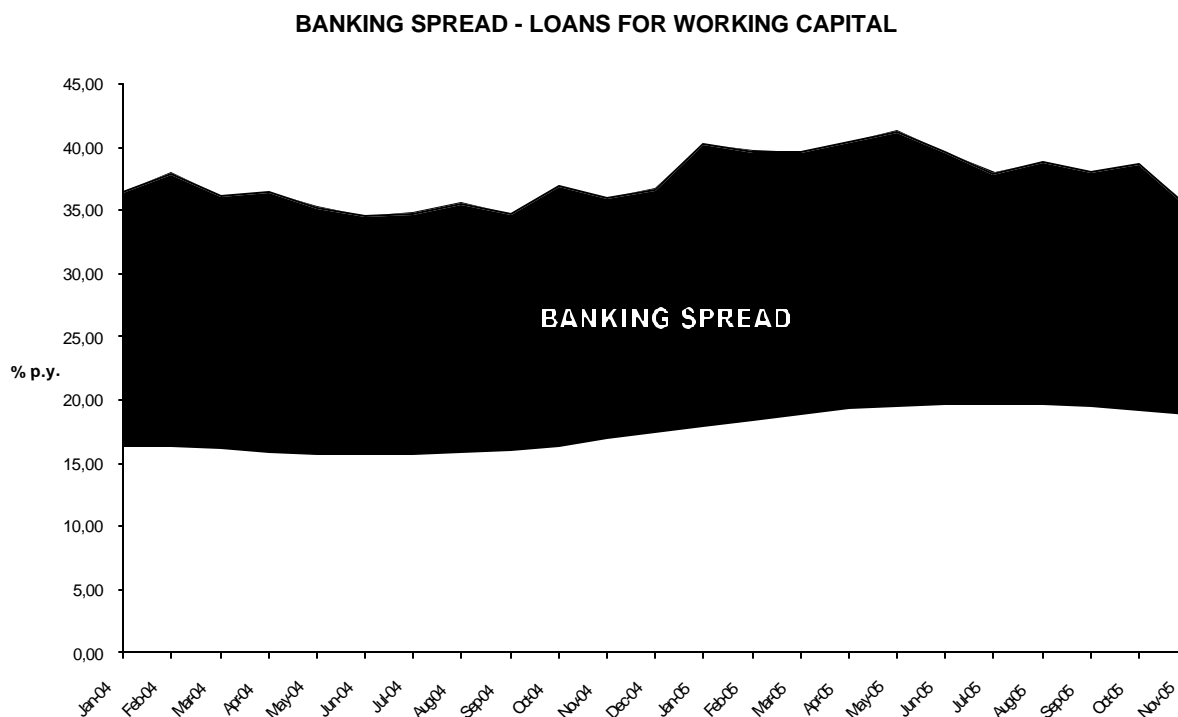
¹⁰ Central Bank of Brazil

Loans for working capital are those that best demonstrate the real cost of credit for Brazilian businesses. These loans represent the necessary financial input to maintaining business activities and, in the majority of cases, result from a process that requires little collateral.

Already in the financing of goods, in general, there exists a necessity for real guarantees and bureaucratic proceedings that can result in elevated costs and become transformed into barriers to entrance for candidate businesses.

In this scenario, taking into account that the financial cost of institutions that operate the National Financial System¹¹ (SFN) is the SELIC (opportunity cost), it is possible to construct Graphic III, which demonstrates the banking spread in Brazil of loans for working capital.

GRAPHIC III



Source: Banco Central do Brasil¹²

¹¹ Sistema Financeiro Nacional

¹² Central Bank of Brazil

According to information available on the website of the Central Bank of Brazil, the practiced rates in the market that make up the data in this graphic are the averages of the market and are calculated using daily rates of financial institutions, weighted by their respective concessions per day.

Thus, since large corporations represent lower risk and are able to more successfully negotiate with banks, micro and small businesses end up dealing with rates even higher than those demonstrated in the above graphic.

Inflation in Brazil

All Brazilians, even the youth of today, know all too well what it is to live with super-inflation. During the 1980s, the devaluation of the currency reached an index on the order of 80% per month.

In this scenario, investments become practically unviable. Therefore, instruments supporting the “protection” of the value of the currency arose to benefit the portion of the population that has a greater power of acquisition, such as remunerated accounts (with daily performance) or financial investment funds.

However, the greater impact falls to the poorest sectors of the population, who have to live with a currency that is losing value with each passing day. Transforming money into food and goods becomes a priority and bartering a daily practice.

In 1994, with the advent of the Real Plan, economic stability was finally established. Since 1999, Brazil has moved forward to conduct a monetary policy based on the System of Inflation Goals (Decree 3.088, June 21, 1999).¹³

The minutes of the 116th meeting of COPOM, held January 17th and 18th, 2006, include the following text, which expresses the current sentiment that the country is passing through with respect to the development of monetary policy.

¹³ Sistema de Metas de Inflação (Decreto 3.088, em 21 de junho de 1999)

The uninterrupted convergence of inflation towards the goals and resultant consolidation of a scenario of lasting macroeconomic stability will contribute to the process of maintaining a progressive reduction of the perception of macroeconomic risk that has occurred in the past few years.

The space to observe a decrease in real interest rates in the future will continue to be quite naturally consolidated as a consequence of these improvements in perception. The COPOM has determined that the cautious actions of monetary policy have been fundamental to augment the possibility of a convergence of inflation towards the desired goals.

In order for this greater probability to continue to be translated into effective results, above all, it is necessary for the prospective indicators of inflation to continue to present compatible elements with the benign scenario that has come to fruition in recent months.

Thus, a gradual relaxation of monetary policy does not compromise the important achievements obtained in the fight against inflation and the preservation of economic growth, generating employment and increasing real income.

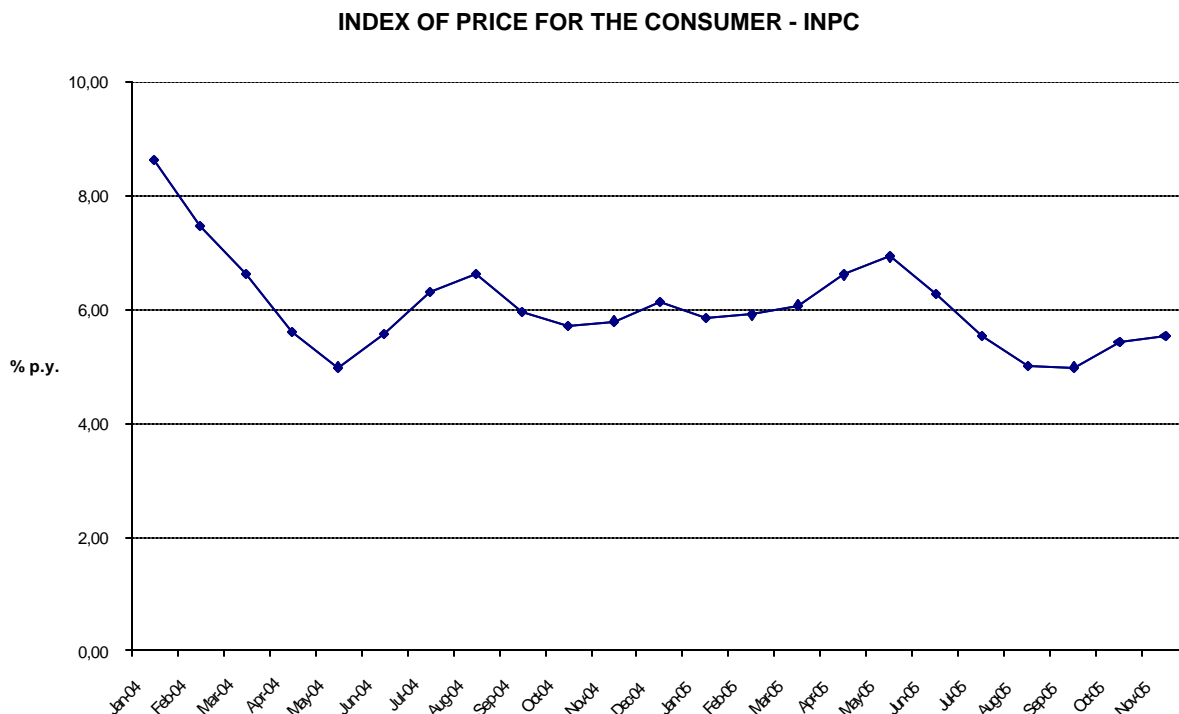
This document demonstrates the importance of gradually relaxing monetary policy. As has been observed previously, this objective will be achieved only to the extent to which Brazil recuperates its capacity for growth and investment.

Said recuperation will depend on a series of factors that are being confronted by the Brazilian government, but which will not have immediate effects. Until the results are consolidated, the country will have to live with elevated basic interest rates to compensate for the effect of low levels of savings and investment.

Graphic IV presents the evolution of the National Index of Price for the Consumer (INPC)¹⁴ since January 2004. The values on the vertical axis represent the percentage accumulated in the last twelve months.

¹⁴ Índice Nacional de Preços ao Consumidor – INPC

GRAPHIC IV



Source: Banco Central do Brasil¹⁵

Long Term Interest Rate - TJLP¹⁶

The variables discussed up unto now demonstrate the difficulties encountered by businessmen and women trying to finance their businesses. This reality is so evident in Brazil that only rarely are micro or small business able to obtain long term credit in the market.

Elevated interest rates, although necessary to avoid a return to the inflationary cycle, make investments greatly unviable. The country therefore confronts two options, it could:

- Let the “cake rise”¹⁷ in order to be able to afterwards promote growth and investment, or
- Create mechanisms that threaten the effects of monetary adjustment.

¹⁵ Central Bank of Brazil

¹⁶ Taxa de Juros de Longo Prazo - TJLP

¹⁷ Deixar o “bolo crescer”

To the end that the economy can not stop, the second option is urgently required. The Brazilian solution to remedy this period of transition is to use the Long Term Interest Rate (TJLP) to finance investments.

The TJLP, instituted on October 31st, 2004 by Emergency Measure number 684, is principally used to define the remuneration of the resources of the Worker Protection Fund (FAT).¹⁸ This fund, which will be detailed at a later point, is the base of the solution determined to make private investment viable in Brazil.

Resources are generally attained by business through programs of the National Bank for Economic and Social Development (BNDES).¹⁹ Those resources diverted specifically to micro and small businesses tend to come from the Program to Generate Employment and Income (PROGER).²⁰

Graphic V consolidates the diverse variables presented and compared to the TJLP. In general, despite the lack of divulged data, the banking spread of investment loans in Brazil falls in the vicinity of 6% per year.

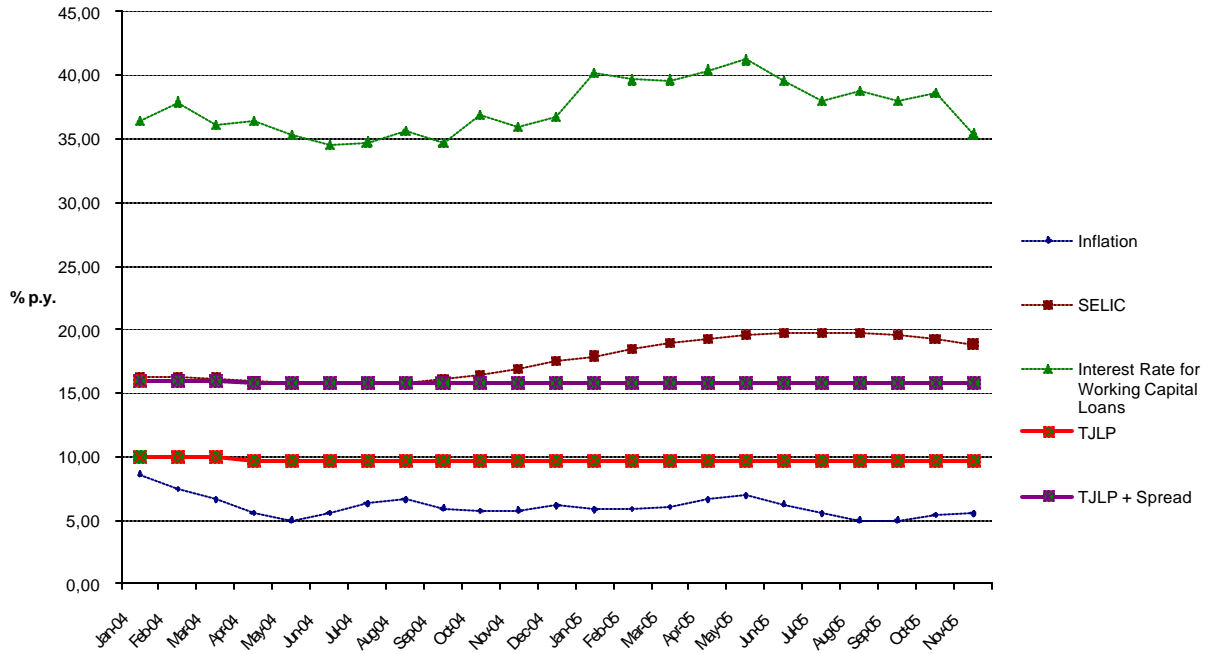
¹⁸ Fundo de Amparo ao Trabalhador – FAT

¹⁹ Banco Nacional de Desenvolvimento Econômico e Social – BNDES

²⁰ Programa de Geração de Emprego e Renda – PROGER

GRAPHIC V

CONSOLIDATED



Source: Banco Central do Brasil²¹

Understanding the above indexes permits us to advance to a discussion of the instruments created, their efficacies, and the conditions of their existence.

²¹ Central Bank of Brazil

WORKER PROTECTION FUND – FAT

In Brazil there exist various regional and some national initiatives that aim to provide incentives to micro and small businesses.

Regional programs headed by state, municipality or non-governmental entities, although of vial importance for local development, do not have the reach or the impact of national programs.

Within the scope of credit destined for this niche in the market, and which have more ample reach, the Constitutional Funds and the Worker Protection Fund (FAT) are particularly relevant.

Constitutional Funds from the North, the Northeast and the Midwest of Brazil instituted through the Federal Constitution of 1988, have the nature of promoting regional development. However, they are scarce and strongly subsidized, thus they end up presenting a limited ability to truly attend to the necessities of micro and small businesses.

More creative solutions to overcoming the difficulties imposed by the macroeconomic environment can be found in the FAT's financial assistance to these businesses.

The FAT, instituted with Law 7998 in 1990, was destined to fund the unemployment insurance program,²² the payment of the salary bonus program,²³ and the financing of programs for economic development.

The principal origin of resources for this Fund is the combination of the Program of Social Integration (PIS)²⁴ and the Program for the Formation of Patrimony of Public Civil Servants (PASEP),²⁵ both taxes on the proscriptions of private businesses and public entities.

In this study, despite the relevance and importance of these activities of worker assistance, we will concentrate our focus on programs dedicated to economic development.

²² Seguro desemprego

²³ Abono Salarial

²⁴ Programa de Integração Social– PIS

²⁵ Programa de Formação do Patrimônio do Servidor Público Civil – PASEP

By order of the Federal Constitution of Brazil of 1988, forty percent of the resources collected are destined to the programs of economic development conducted by the BNDES, the National Bank for Economic and Social Development.

Although the BNDES makes financing available to micro and small businesses, the concession procedures must be optimized since they are currently making the process morose and costly.

Other activity destined for economic development, and which has its origin in the resources of FAT, is the PROGER, the Program to Generate Employment and Income.

The PROGER is constituted of diverse lines of financing that are instituted and regulated by the Deliberative Advisement of FAT - CODEFAT.²⁶ This Advisement is triply composed of participating representatives of the Federal Government, laborers, and employers.

These lines of credit are destined to naturally entrepreneurial individuals and businesses and do not discriminate between those in the agricultural sector and those in the urban sector.

In Brazil, micro and small businesses are concentrated in urban areas. Rural activity, in general, is carried out by individuals, by cooperatives, or by large businesses.

Thus, in the search to delineate the subject of this study, the discussion will deal only with the PROGER related to urban activity and the available lines of credit destined for micro and small businesses.

More details about the PROGER and the available lines of credit can be obtained on the website of the Minister of Work and Employment of the Brazilian Government – www.mte.gov.br.

²⁶ Conselho Deliberativo do FAT - CODEFAT

The urban aspect of PROGER primarily deals with businesses that have an annual revenue of less than five million reais²⁷, and thus coordinates the following lines of credit destined for micro and small businesses:

- Micro and small businesses- Isolated working capital,
- Micro and small businesses- Investment.

There still exist special lines destined to specific sectors, such as tourism and exportation, which will not be discussed in this study.

A few particularly striking numbers illustrate the dimension and importance of FAT, such as, for example (data from December 2004):

- Patrimony of Funds- \$102,886 Million Reals;
- The volume applied through the PROGER to micro and small businesses- 4,696 Million Reals.

The loans are processed through official federal banks in Brazil such as: the Banco da Amazônia, Banco do Brasil, Banco do Nordeste do Brasil and the Caixa Econômica Federal.²⁸

With respect to these types of credits, the TJLP, which remunerates the resources made available by the fund, and the spread destined for participant banks make up the interest paid by the final recipients of the credit.

²⁷ Brazilian currency

²⁸ Bank of the Amazons, the Bank of Brazil, the Bank of Northeastern Brazil, and the Federal Economic Caixa

THE EXPERIENCE OF THE CAIXA ECONÔMICA FEDERAL

With the goal of illustrating the results attained through the politics of utilizing the resources of the FAT to foment the growth and sustainability of micro and small businesses, this paper will explore the recent experiences of the Caixa Econômica Federal, the Caixa.

The Caixa is a financial state institution (owned exclusively by the Federal Government), founded in 1861 under the denomination of Monte do Socorro.²⁹ The historic identity of the Caixa is to attend to the poorest sectors of the Brazilian population.

Financing infrastructure, particularly basic sanitation, public housing, and the distribution of public policies like the “bolsa escola” (school assistance) program and the payment of unemployment benefits are just some of the activities that the Caixa has been able to support in addition to the characteristic functions of a banking institutions.

Since 1999, with the advent of the Brazilian Entrepreneurial Program,³⁰ the Caixa has acted jointly with diverse areas of the Federal Government to help micro and small businesses; the Caixa has thus intensified its actions in this niche of the market.

There are many challenges to be confronted in the concession of loans and finances for businesses of this size. The most expressive is the investment necessary to the evolution of the learning curve of this innovative concessionary activity in Brazil. Financial institutions, up unto this point, have passed on to the final price all the risk represented by operating with small businesses.

In order to make operations more viable using appropriate interest rates for business activities and, particularly, adjustments to make investments feasible, it was necessary to mitigate risks and construct tools that make viable the concession of a cost able to be covered by the revenue generated by low value credits.

²⁹ Assistance Fund

³⁰ Programa Brasil Empreendedor

Investments undertaken by businesses, in general, aim to expand installations or acquire machines and equipment. With modern statistical tools and using informational techniques, the Caixa made attending to local needs locally possible with its widespread network of agencies for micro and small businesses.

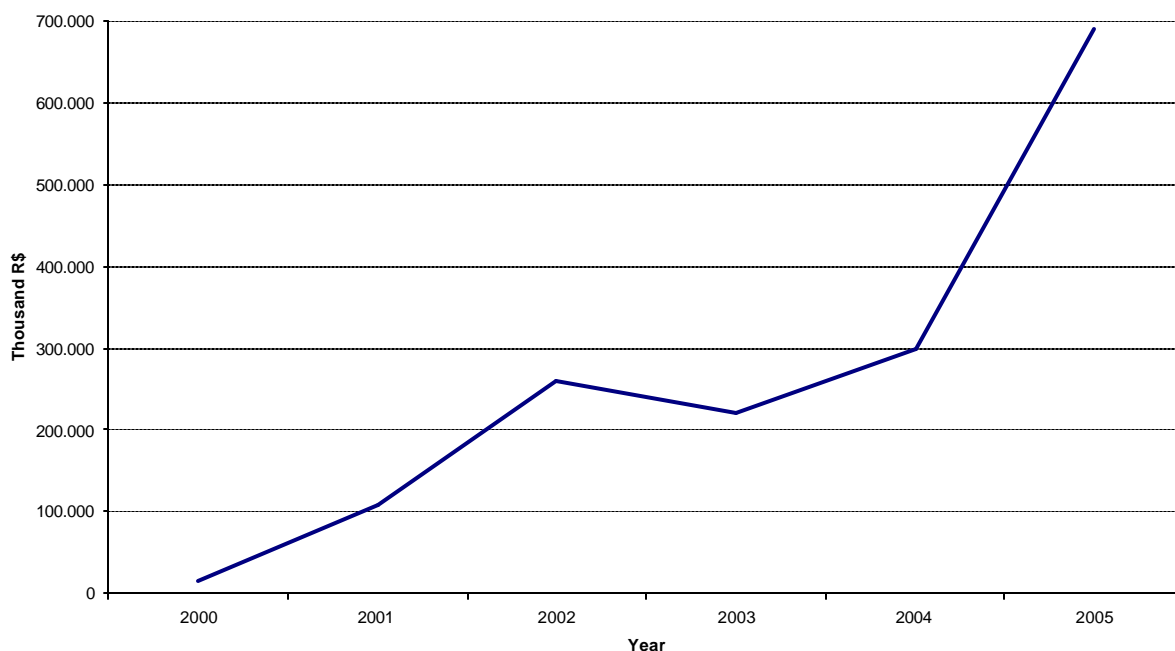
The Caixa has 2237 establishments spread throughout the nation that have this capacity. These agencies are able to undertake evaluations of the businesses finances and the viability of investment in projects with values up to \$50,000 Reals.

These technological and operational solutions permit the dispensation of appropriate levels of risk and an appropriate cost for credit.

This enables the Caixa to make adjusted credits available to the needs of MPE in order to finance investments, in the composition of interest charged plus the dispensation of the resources of the FAT.

Graphic VI demonstrates the yearly values of credits destined to investments with FAT resources. The graph measures values since 2000, the year in which the Caixa effectively initiated the work of PROGER- Micro and Small Businesses. The dip in 2003 is due to the reevaluation of instruments to measure risk, a process that allowed for the return to the evolution of growth in the subsequent year.

Considering that they are credits with partial repayment schemes, and that, in general they continue for more than 30 months, it can be inferred that a large part of the financing are operations in which each loan is destined for a different client. Thus, in the below five years and a few months of activity, the Caixa has already financed more than 39,800 businesses.

GRAPHIC VI**FINANCING FOR INVESTMENTS – PROGER**

Source: Caixa Econômica Federal

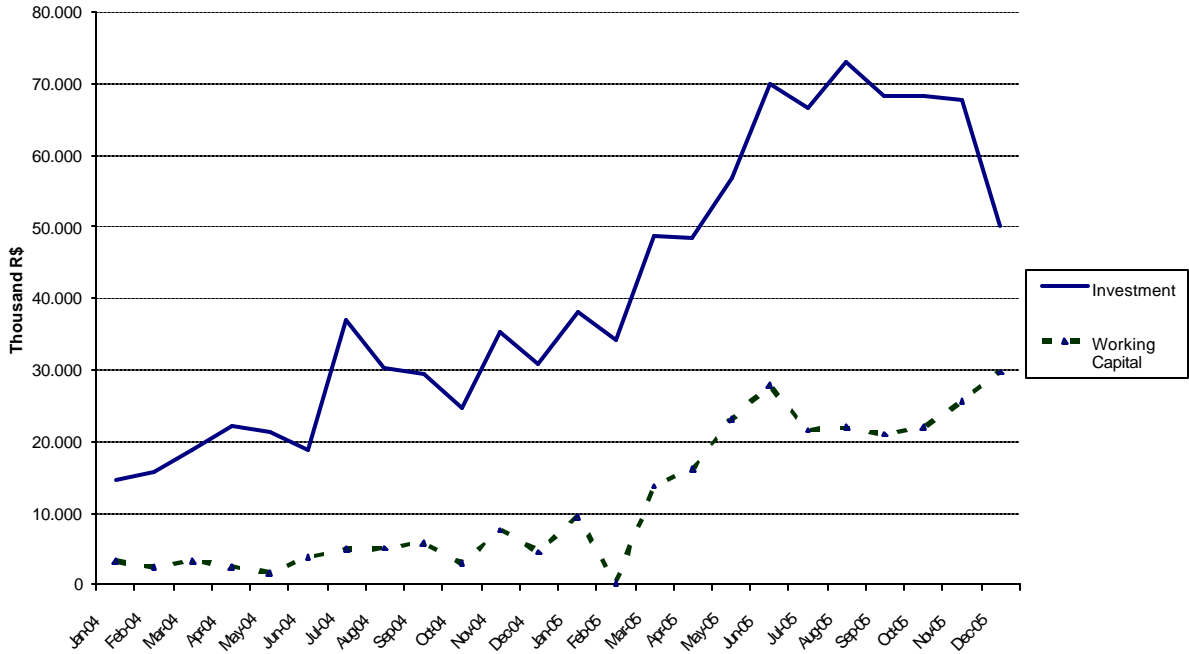
It is thus possible to verify the strong expansion of the concessions of credit demonstrated by the consolidation of the product in the Brazilian market.

The benefits generated by the policy of utilizing FAT resources are evident. Besides making possible the generation of jobs by thousands of micro and small businesses, to the extent that access to credit presumes fiscal regularity of businesses, more firms of this dimension are escaping illegality and collecting their taxes.

Graphic VII presents the month-to-month evolution over the last 24 months of the lines of PROGER extended to micro and small business in Caixa. This graphic shows the evolution of, beyond the applications in investment, loans destined to working capital that utilize FAT resources.

GRAPHIC VII

LINES OF CREDIT PROGER – CAIXA FOR MICRO AND SMALL BUSINESSES



Source: Caixa Econômica Federal

Observe the strong growth, which reflects the improvement of processes within the Caixa, the training of attendant personnel, and, probably, the elevation of demand to the extent that more businesses envision the possibility of obtaining credit with appropriate interest rates for their activities.

THE PROBLEM AND ITS IMPORTANCE

Contextualizing the scenario that Brazilian business activity finds itself in; observe the limited attractiveness of investments, a situation which necessitates that businesses produce an internal rate of return on the order of at least 16% per year.

The motive for the elevated basic interest rate seems fairly clear; Brazil has an elevated fiscal deficit originating from burdensome state expenditures. This deficit is financed by the formation and augmentation of an internal debt on the order of one trillion reais (value in February 2006), equivalent to 56% of the GDP registered in 2004.

More information about the value of the public debt in Brazil can be obtained on the National Treasury website at – www.tesouro.fazenda.gov.br.

The motives behind the accumulation of this deficit are extremely varied. However, as any citizen knows, it is essentially a result of the state spending more than the total of all resources collected.

Some of the actions that have begun to consolidate within the democratic process in Brazil have already been cited. It does not detract to point out anew the Law of Fiscal Responsibility (Complementary Law number 101, May 4, 2000)³¹, the Reform of the Public Retirement Fund (Constitutional Amendment number 41, December 19, 2003),³² and the improvement of collection and oversight activities.

All of these improvements will have medium and long term effects. In the short term, and as a result of investments from the past few years, Brazilian businesses have improved their efficiency and are augmenting their presence in the international market.

The continuation of these improvements in efficiency depends on constructing a network of product and service providers that evolve harmoniously. The MPE are inserted into this network.

³¹ Lei de Responsabilidade Fiscal (Lei Complementar nr 101, de 04 de maio de 2000)

³² Reforma da Previdência (Emenda Constitucional nr 41, de 19 de dezembro de 2003)

The MPE have strategic importance for Brazil. The country has inexpensive labor. Following the example of countries like China and India, the necessary factors exist to attract much higher levels of investment and growth than those currently enjoyed.

Public policies that aim to reinforce this chain reaction of sustaining the Brazilian economy should be adopted. In this group there is an aim to encourage loans and financing at cost levels compatible with productive activity.

However, isolated financial assistance is of little help. Brazil must revise the bureaucratic processes that have historically generated elevated costs for businesses.

Hernando de Soto, president of the Institute for Liberty and Democracy, which has its headquarters in Lima, Peru, described in his book *The Mystery of Capital*, the conditions to which businesses are subjected in developing countries.

To get an idea of just how difficult the migrant's life was, my research team and I opened a small garment workshop on the outskirts of Lima, Peru. Our goal was to create a new and perfectly legal business. The team then began filling out the forms, standing in the lines, and making the bus trips into central Lima to get all the certifications required to operate, according to the letter of the law, a small business in Peru. They spent six hours a day at it and finally registered the business – 289 days later. Although the garment workshop was geared to operating with only one worker, the cost of legal registration was \$1,231 – thirty-one times the monthly minimum wage.

Some programs with the goal of combating the costs associated with bureaucracy have been adopted by the federal government as well as by state and municipal governments. In this effort one must include the actions of the Ministry of Development, Industry, and External Commerce for Local Productive Arrangements (APL).³³

The assistance provided to APL operates with the joint action of diverse local actors in coordination (businessmen, syndicates, acquisitions, training entities, education, credit, technology, and development agencies, among others).

³³ Ministério do Desenvolvimento, Indústria e Comércio Exterior nos Arranjos Produtivos Locais – APL

By first identifying the characteristics necessary to improve the diverse levels of productive chains, one can then find the adequate and feasible solutions.

More information about the APL can be obtained on the website of the Ministry of Development, the Industry of External Commerce³⁴ – www.desenvolvimento.gov.br

Entities like SEBRAE and the Caixa have accompanied the work, together with the APL, and have acted decisively and strongly to resolve the demands. The question, already discussed, of elevated interest rates appears also as a point to be improved with regard to the APL.

Other legislations put the incentives for entrepreneurship in practice and demonstrated the attention the Brazilian Government is giving to micro and small businesses. Among these legislations, the following two deserve particular mention: the Statute of Micro and Small Businesses (Law 9.841, October 5, 1999)³⁵ and SIMPLES (Law 9.318, December 5, 1996).³⁶

This last law deals with the tributary regime, applicable to micro and small businesses, that, according to the SEBRAE site, “consists of a simplified and unified form of collecting tributes through the application of favorable and progressive percentages, incidents with one sole base of calculation, total revenue.”³⁷

Providing financial instruments that can shed light on the high interest rates for the activities of Micro and Small Businesses is the current problem to be confronted an whose importance has the potential presented in this segment (see data presented in the introduction).

³⁴ Ministério do Desenvolvimento, Indústria e Comércio

³⁵ Estatuto da Microempresa e da Empresa de Pequeno Porte (Lei 9.841, de 05 de outubro de 1999)

³⁶ SIMPLES (Lei 9.318, de 05 de dezembro de 1996)

³⁷ “consiste de uma forma simplificada e unificada do recolhimento de tributos por meio da aplicação de percentuais favorecidos e progressivos, incidentes sobre uma única base de cálculo, a receita bruta”

HYPOTHESIS OF THE PROBLEM

The problem heats up with the question of what the objective of this study will be:

Is utilizing a Public Fund, such as the source of resources for credit for MPE, an efficient instrument for the growth and generation of employment and income?

Therefore, two hypotheses follow from this question to be formulated as follows:

H0 – Financial mechanisms made available by the Brazilian Government provide incentives to the development of MPE.

H1- Financial mechanisms made available by the Brazilian Government do not provide incentives for the development of MPE.

Public Funds

Brazil dispenses aid from four funds that attend to the demands of MPE. Besides the FAT, there are three other funds dedicated to providing incentives for regional development.

The funds are as follows:

- Northern Constitutional Fund³⁸– FNO, administrated by the Banco da Amazônia³⁹ with the mission of financing projects that support Northern regional development;
- Northeast Constitutional Fund⁴⁰ - FNE, administrated by the Banco do Nordeste,⁴¹ with the mission of financing projects that support Northeastern regional development ;
- Midwest Constitutional Fund⁴²- FCO, administered by the Banco do Brasil⁴³ with the mission of financing projects that support regional Midwestern development.

These funds are provided by from government resources in a manner determined by the Federal Constitution of 1988:

³⁸ Fundo Constitucional do Norte

³⁹ Bank of the Amazon

⁴⁰ Fundo Constitucional do Nordeste

⁴¹ Bank of the Northeast

⁴² Fundo Constitucional do Nordeste

⁴³ Bank of Brazil

Article 159. The Union will deliver:

l – the product of tax collection for income and profit from all sources and on all industrial products, forty seven percent in the following way:

...

c) three percent for the application of financing programs for the productive sectors of the Northern, Northeastern, and Midwest regions through the regional financial institutions and in accordance with regional development plans, assuring that the semi-arid region of the Northeast receives half of the resources destined for the region, in the forms established by law;

The resources are applied through programs of regional development in the neediest areas of the national territory. The financial contracts are based in the TJLP, represent a huge advantage for credit collectors and supply, although in part due to a scarcity of resources, the necessity of threatening the effects of elevated interest rates.

At this juncture one observes the subsidizing effect of the state once these resources move directly from collection to the formation of funds destined exclusively to the concession of credits. In Economics in One Lesson, Henry Hazlitt describes various examples that personify the passage that follow:

There is no more persistent and influential faith in the world today than the faith in government spending. Everywhere government spending is presented as a panacea for all our economic ills. Is private industry partially stagnant? We can fix it all by government spending. Is there unemployment? That is obviously due to "insufficient private purchasing power." The remedy is just as obvious. All that is necessary is for government to spend enough to make up the "deficiency".

...

Everything we get, outside of the free gifts of nature, must in some way be paid for.

Corroborating Hazlitt's words, I do not believe that the Constitutional Funds represent the ideal solution to the problem of the interest rate for several reasons. A primary point is that using these funds in this manner burdens the state, which could otherwise use these resources on infrastructure for these same regions. A second point is that this use of funds points out the privilege of localized businesses in this region that do not necessarily need the subsidy.

Interest Charged on Loans from Fund Resources versus Governmental Subsidies

Before embarking on an impassioned defense of the question of the use of the TJLP, when utilized to increment official funds, to represent or not governmental subsidies, it is clear that if the government pays a higher interest rate in the short term, the TJLP causes an economic danger to the funds.

However, in the face of the resulting benefits and the possibility of making the undertakings of micro and small businesses possible, the results return to society in the form of jobs and the generation of income to justify this application of funds.

The TJLP is an interest rate for the long term and, in the case of this study, is destined to increment official funds when the resources are applied in loans and financing destined for social and economic development.

It is important to point out that the resources of the FAT, when not loaned to the final destination, make up part of the market and receive remuneration compatible with the SELIC.

Loans realized, by being destined to financing investments, are considered long term only if they have at least 24 monthly parcels of repayment.

The legislation that created the TJLP already defined the method of calculation as determined below:

MEDIDA PROVISÓRIA⁴⁴ N° 684, Of October 31, 1994

Article 2° The TJLP will be calculated using the average normal profit value, in national currency, verified in the period immediately anterior to its force, the titles of the external and internal of voluntary acquisition Public Debt.⁴⁵

Article 3° The norms that article 1 refers to, in the end, to be decreased by the National Monetary Advisory⁴⁶, will be dispersed, among other aspects, to:

⁴⁴ Provisionary Act

⁴⁵ Dívida Pública

⁴⁶ Conselho Monetário Nacional

I – period of enforcement of the TJLP, observing the minimum timeframe of 3 (three) months;

II – minimum timeframes for the justification of long term titles;

III – specification of titles of the internal and external Public Debt that will serve as the basis of the calculation of the TJLP;

IV – the duration of the period of verification of the profit value, referred to in the clause of article 2 and;

V – the proportions in which the nominal average profit value in national currency of each title will be considered in the calculation of the TJLP.

One can observe that the TJLP is calculated with the base in the same compensation paid by the government in the issuance of long term titles of the public debt.

Another important factor is that the remuneration of Funds, without considering the constitution of other prescriptions such as, for example, the SELIC of values not applied, surpasses the inflation registered in the country as observed in Graphic V.

A traditional Brazilian savings investment is a savings account that yields an interest rate of 6% per year more than the Referential Rate⁴⁷- TR, put together these values do not surpass the TJLP.

The risk on loans put in place is assumed by lending banks that are government businesses and, therefore, represent a sovereign risk.

The fact that it has not been remunerated by the SELIC, truly expresses that the Funds are completing their roles and not speculating against the State.

It is important to highlight that the interest rate is in discussion, and not the existence of the same funds. One can not justify state intervention into the market with a constitution of funds exclusive for credit to micro and small businesses. However, the utilization of the resources of the FAT is an innovative form of supplying this necessity.

⁴⁷ Taxa Referencial

The FAT is destined to the expenditures of the program of unemployment allowances and to the payment of a salary bonus: two existing programs in many diverse societies that demand the collection of funds or governmental budgeting.

Credit as a Necessity Input to the Growth and Maintenance of Businesses

The definition of credit, in its simplest conception, is the delivery of one good to others to be returned in the future. These goods may be interchangeable or not.

Currency, which by definition is interchangeable, is the instrument made operational by the financial market and which allows the balance between savings and investments. This function, exercised by the National Financial System,⁴⁸ promotes economic and social development.

In general, credits are made available to investors and, in the scope of interests of this study, we can classify them as either those with, or those without a specific destination.

In the absence of a specific destination, and when the recipient is a legal entity, it is designated as working capital, since it allows the reinforcement of the reserve necessary for the operational cycle of businesses.

Credits with a specific destination, in the case of businesses, are usually destined for investments in reforms or enlargements of plants or in the acquisition of machines and equipment.

Businesses need to settle their cash flows routinely. Similarly, to maintain themselves in the market, it is indispensable for businesses to constantly update their technology. Surviving in a market without the effective partnership of financial institutions is a tremendous challenge.

Large companies are able to make use of many diverse forms of credit. Instruments such as debentures or the formation of Funds of Investment in Credit Rights - FIDC⁴⁹, all without intermediation, are accessible to these businesses.

⁴⁸ Sistema Financeiro Nacional

⁴⁹ Fundos de Investimentos em Direitos Creditórios

The small businessman or woman does not have access to these markets in Brazil. Nonetheless, he or she has the same necessities of maintaining and investing in their undertakings.

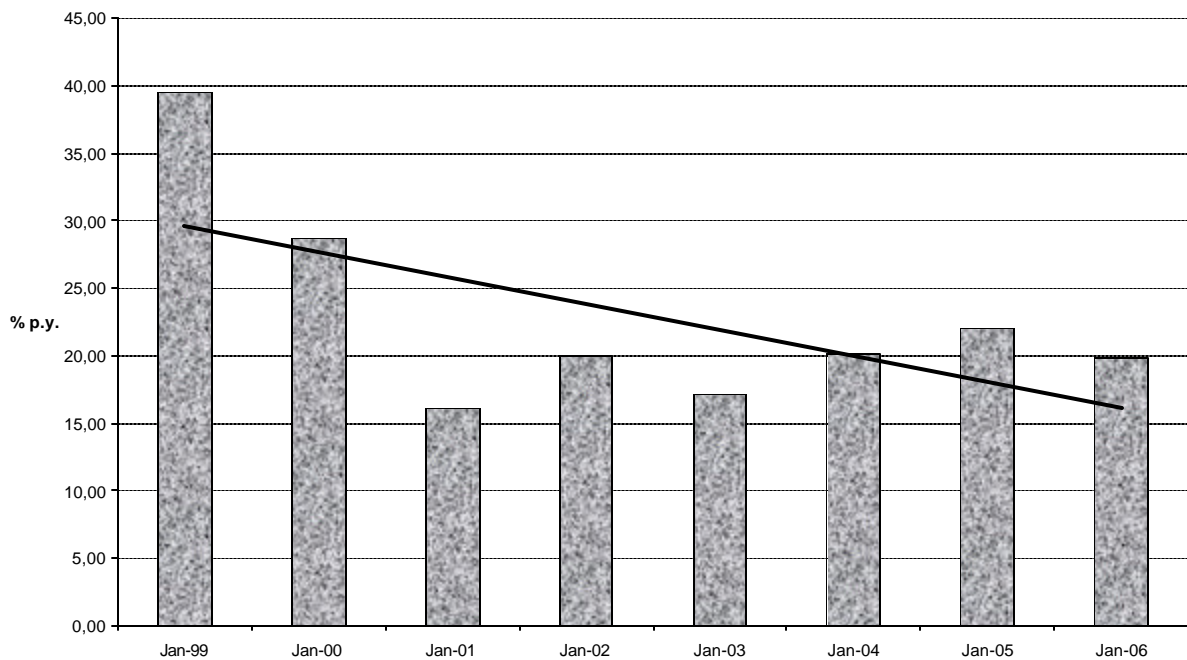
Without a modern, active, and competitive financial market, economic development becomes slower and more difficult. The Brazilian financial system has demonstrated maturity and creativity and is able to adapt to the stable economic environment.

The cost of credit to the final recipient has fallen over the course of the past few years; a result of the competition established such that banks return to the market and must leave the process of mere speculation made possible by inflation.

Graphic VIII demonstrates the tendencies in loans destined for working capital. The graph shows the spread gathered by banks, or in other words, the difference between the interest rates charged on loans and the SELIC rate.

GRAPHIC VIII

EVOLUTION OF THE SPREAD IN LOANS FOR WORKING CAPITAL



Source: Banco Central do Brasil⁵⁰

⁵⁰ Central Bank of Brazil

With the consolidation of this tendency and a decrease in the SELIC rate, interest rates will reach levels that will stimulate micro and small businesses.

FINAL CONSIDERATIONS

There is no doubt as to the importance of Micro and Small Businesses in the Brazilian market. Furthermore, there is an evident need for partnerships between businesses and Financial Institutions⁵¹ in order to promote economic development.

The macroeconomic scenario in Brazil demonstrates the adoption of measures in the fiscal and monetary sphere that aim to consolidate economic stability and promote growth.

In this fertile environment, thousands of people seek to make their livings with small businesses. These establishments, when well administered, assist growth and generate employment and income.

One often sees such growth stifled by a diverse range of issues. Many are barriers coming from sources as varied as governmental bureaucracy and the difficulty in accessing financial resources at costs comparative with business activity.

Large businesses have greater bargaining power, and so obtain resources in the market at low costs, by Brazilian standards. In general, the interest rates in practice are equivalent to the SELIC, or, depending on the financial instrument used, even lower.

Micro and Small Businesses, for diverse reasons, are unable to negotiate such good deals. The cost of capital for these businesses ends up being burdensome, which in turn discourages entrepreneurs from bringing their investments to fruition.

The Brazilian private market is growing and needs all productive chains to evolve in a harmonious manner, thus guaranteeing efficiency and competitively.

The opening of the Brazilian market to international commerce has occurred gradually and continues to require, increasingly every day, the structuring of business activity.

⁵¹ Instituições Financeiras

In this context, it is fundamental to act within the financial market. Without a partnership with the banks and other institutions involved in this activity, the businesses are limited, hence they do not access the resources of third parties that are the input necessary for achieving business ends.

The maintenance and expansion of micro and small businesses will be promoted with more efficiency when financial mediation results in interest rates that stimulate the businesses.

As such, the government should not simply continue to pursue the budget surplus, but must also look to stimulate competition within the Brazilian banking market. The economic stability already demonstrated that competition between banks results in decreasing the banking spread.

Deregulating the banking sector and permitting other institutions to act in this market may be the appropriate direction to follow in search of this result.

While not approaching the ideal situation, the government has placed resources at the disposition of the MPE, which permits the reduction of the cost of capital.

The hypothesis raised, that these financial mechanisms give incentive to the development of the MPE is certainly true. However, despite correcting this assertion, the policies adopted will not sustain themselves in the long term. The resources are finite and demand is growing.

With measures that are transitory and which will come to be substituted in the near future by market forces, utilizing the resources of the FAT to finance MPE is, in my opinion, efficient and adequate.

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CONSTITUIÇÃO DA REPÚBLICA FEDERATIVA DO BRASIL, DE 05 DE OUTUBRO DE 1988

LEI Nº 7.998, DE 11 DE JANEIRO DE 1990

Regula o Programa do Seguro-Desemprego, o Abono Salarial, institui o Fundo de Amparo ao Trabalhador (FAT), e dá outras providências.

MEDIDA PROVISÓRIA Nº 684, DE 31 DE OUTUBRO DE 1994

Institui a Taxa de Juros de Longo Prazo (TJLP), dispõe sobre a remuneração dos recursos do Fundo de Participação Pis-Pasep, do Fundo de Amparo ao Trabalhador, do Fundo da Marinha Mercante, e dá outras providências.

LEI Nº 9.069, DE 29 DE JUNHO DE 1995

Dispõe sobre o Plano Real, o Sistema Monetário Nacional, estabelece as regras e condições de emissão do Real e os critérios para conversão das obrigações para o Real, e dá outras providências.

LEI Nº 9.317, DE 5 DE DEZEMBRO DE 1996

Dispõe sobre o regime tributário das microempresas e das empresas de pequeno porte, institui o Sistema Integrado de Pagamento de Impostos e Contribuições das Microempresas e das Empresas de Pequeno Porte - SIMPLES e dá outras providências.

DECRETO Nº 3.088, DE 21 DE JUNHO DE 1999

Estabelece a sistemática de "metas para a inflação" como diretriz para fixação do regime de política monetária e dá outras providências.

LEI Nº 9.841, DE 5 DE OUTUBRO DE 1999

Institui o Estatuto da Microempresa e da Empresa de Pequeno Porte, dispendo sobre o tratamento jurídico diferenciado, simplificado e favorecido previsto nos arts. 170 e 179 da Constituição Federal

LEI COMPLEMENTAR Nº 101, DE 4 DE MAIO DE 2000

Estabelece normas de finanças públicas voltadas para a responsabilidade na gestão fiscal e dá outras providências.

EMENDA CONSTITUCIONAL Nº 41, DE 19 DE DEZEMBRO DE 2003

Modifica os arts. 37, 40, 42, 48, 96, 149 e 201 da Constituição Federal, revoga o inciso IX do § 3º do art. 142 da Constituição Federal e dispositivos da Emenda Constitucional nº 20, de 15 de dezembro de 1998, e dá outras providências.

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www.desenvolvimento.gov.br – Ministério do Desenvolvimento, Indústria e Comércio- Minister of Development, Industry, and Commerce

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