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The Impact of Nationalization of Public Debt through On-Lending Agreements According to Brazilian Financial Law

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Abstract

The present article examines the nationalization of external public credit agreements in Brazilian financial law, focusing on the nuanced legal interpretation of on-lending operations within Brazil's fiscal rules. It explores the role of external credit in developing economies, with a specific lens on Brazil's legal mechanisms for authorizing such financial activities. The paper delves into the differentiation between internal credit and external credit operations and the implication of such a distinction for public debt control, emphasizing the legal and economic considerations unique to Brazil's context. The article also discusses the role of the Federal Senate in authorizing external financial operations and regulating public indebtedness. Through an analysis of on-lending agreements, the paper illustrates how these financial instruments can facilitate foreign capital access for national development, bypassing the more cumbersome approval processes of external credit agreements. Therefore, this work aims to contribute to understanding Brazil's financial law and its impact on the country's economic policy and debt management strategies.

Keywords

Public Debt, External Credit, On-Lending Agreements, Loan Agreements, Brazilian Fiscal Rules

1. Introduction

For developing and emerging market economies, external credit can be an important source of funding either for public or private sectors (Ağca & Celasun, 2009). Still, the perils of excessive external debt, especially in federal countries, justify the existence in several jurisdictions of specific rules for authorizing ex-

ternal financial operations prior to their contracting (Ter-Minassian, 1997). In Brazil, those rules relate to the authority exercised by the Federal Senate as guardian of states' interests and balance.

The concept of external credit operation in Brazilian Law though is not straightforward, giving rise to different interpretations of the requirements for signing different contracts aiming at mobilizing external sources of financing. The aim of the present paper is to provide the basis for the correct interpretation of "on-lending operations" within the realm of Brazilian fiscal rules.

Our goal is thus to show that on-lending operations can be justified because they are an instrument for reducing information asymmetries between foreign lenders and domestic borrowers, enhancing the availability of foreign capital for financing national development. As such, on-lending agreements cannot be equivalent, from a legal perspective, to external credit agreements, which bring upon it several consequences, the most important of which is the lack of the requirement for Federal Senate authorization before its implementation.

2. External Credit Operations with Public Entities: The Role of the Federal Senate

The famous clash between the "founding fathers" of the United States of America on the public debt and its role in the development of American capitalism shows how disputed this question can be. Seen as a blessing by Alexander Hamilton (Hamilton, 1790), the public debt was considered by Thomas Jefferson and James Madison as being an avenue for government corruption of the public interest, justifying its rigid control and limitation (Desmedt, 2014).

Public credit gained greater acceptance in economic literature as a common source of obtaining resources for the State, even in times of peace and normality, because of the marked influence of J. M. Keynes' ideas regarding the role of public spending in increasing aggregate demand and favoring economic growth. This trend was observed after the 1930s, having lost strength after the 1970s, as a result of budget crises experienced by over-indebted governments (Assoni Filho, 2007). This was also observed in Brazil.

As a country young, initially with a lack of domestic capital, Brazil developed its industry late compared to other countries. Its process of capital accumulation for industrialization initially occurred because of the relative success of its export agriculture in the beginning of the 20th century (Gremaud et al., 2012). Throughout this century, though, the country suffered from episodes of crises in its balance of payments (Furtado, 2007), denoting the country's dependence of external savings for its development, the low capacity to generate foreign exchange considering the little diversity of its exports list and, after the decade 1970, the country's high external debt (Gremaud et al., 2012). Difficulties in obtaining foreign currency, combined with low domestic savings, have historically presented themselves as limiting factors for national development, having been overcome, to a certain extent, only in more recent years, made possible by the

increase in national reserves (Franco, 2018).

Brazil has a long history of public debt, a history that begins with the formation of Brazil as an independent nation (Assoni Filho, 2007), although one could go back further into Brazilian history to the point of identifying the origin of part of our debt in Brazil's colonization enterprise (Abraham, 2015). This ancient relationship with public debt is not, however, a characteristic sign of Brazil, being, on the contrary, shared with most countries (Rogoff & Reinhart, 2011).

Using debt as a way of financing government expenses has been widely criticized in the past, because it would divert resources from private productive sectors (Abraham, 2015). This argument was especially relevant in the past, when the functions of the State were limited in relation to those provided for in today's modern social constitutions, and when state assets were often confused with the ruler's private assets. More recently, though, the debate has expanded in economic literature and practice, with the defense of public spending, even in a situation of deficit, as a way of stimulating aggregate demand and filling the occasional production gap, putting the economy back on track.

Although it was seen in the past as a negative and exceptional element, credit is currently absolutely incorporated as an ordinary source of financing for State action (Ataliba Nogueira, 1973). Understanding the stabilizing role that the State plays in the economy was the theoretical support for abandoning the strict consensus on the need to observe budget balance annually. Until then, such balance was taken as a premise, only removed in critical moments of war. To this understanding were added increasingly strong social demands for a greater supply of public goods and services, completely changing the size of the State in relation to previous historical periods (Oliveira, 2013).

Public credit has some important economic effects, such as helping to control inflation, especially when the resources raised are not used to finance current expenses, and increasing the government's financial liquidity in periods of greater budgetary restrictions resulting from times of economic downturn (Abraham, 2015). Public debt also presents other economic functions as the establishment of a reference for interests in different maturities, which helps in the development of the domestic financial and capital markets. The main economic effect of public credit of interest to Law, however, concerns its ability to shift the financial burdens of government action over time. This effect especially interests Law, because of its implications for Justice, from an inter-temporal or intergenerational perspective (Arellano, 2020).

The difference between public and private credit is based on the figure of the credit borrower and, therefore, on the purpose arising from obtaining it. As the borrower is a public entity, it is expected that it will be obtained in the general interest of society, therefore, to serve the public interest (Assoni Filho, 2007: p. 797). However, this will not always happen, and the case of repudiation of debts assumed in political regimes transitions (such as from dictatorships to democra-

cies), is not uncommon in history (Drago, 1907: p. 32).

Public credit results from the perpetuity that is presumed for the state figure, besides its power of empire over the citizens of its territory, who are subject to the State's taxing power, exercised within self-imposed constitutional limits. It is easy to deduce that such an entity, perennial and with powers to appropriate the wealth existing in its territory or owned by its citizens, presents, other things being equal, a lower risk of default than a private entity (Ataliba Nogueira, 1973: pp. 21-23).

However, if the State has greater ease than private subjects in obtaining resources, the State is also less susceptible to pressure to pay its debts, given the sovereign power it exercises over its territory and the impossibility of forced execution on its assets (Ataliba Nogueira, 1973: p. 275). Even if we assume the possibility of the State coming to legal responsibility for non-payment of its debts, whether within its own jurisdiction or in arbitration proceedings, the fact is that most times there are no foreclosures against the State in the technical sense. This is because the doctrine considers that the voluntary fulfillment of the obligation by simple order to the directed party, which is the procedure to be followed, for example, with debts arising from court orders in Brazil ("precatórios"), is not exactly forced execution (Ataliba Nogueira, 1973: pp. 252-253).

It is worth noting though that, from an economic point of view, the major consequence of defaulting on public debt is the loss of public credit by the debtor entity. Since the Brazilian Constitution provides, because of the fundamental right to equality, the existence of a principle of intergenerational balance (Arellano, 2020), then the loss of such credit comprises a consequence to be inherited by future generations.

Because of the effects that debt can produce on the entire society, its present and future generations, the Brazilian legal system, throughout its constitutional history, has always kept to the Legislative branch the role of protagonist in the debate and deliberation about debt, even in times of greatest authoritarianism (Abraham, 2015: p. 180). Stricter regulation for public debt was formed at the end of the 1960s, especially with the 1967 Constitution (worded by Constitutional Amendment No. 1 of 1969) which changed the tradition of greater flexibility. In the infraconstitucional level, Law no. 4,320, from 1964, had already brought advances in relation to the financial and budgetary framework in force until then.

Currently, the Brazilian Constitution of 1988 provides that it is the responsibility of the National Congress to rule, with the sanction of the President of the Republic, on credit operations and public debt (art. 48, II). The form of provision on such matters must comply with article 163 of the Constitution, which provides that a complementary law should regulate the external and internal public debt, including that of autarchies, foundations and other entities controlled by the State. More recently, the same article was amended to establish that the complementary law should also define conditions for the debt sustaina-

bility (Constitutional Amendment no. 109/2021).

Losing credit resulting from non-payment of the debt may be more or less serious, depending on the context of the default and its extent. Still, one cannot lose sight of the fact that the Constitution tries to protect society against the negative effects of the loss of public credit, doing so through specific rules that provide for prioritization in the payment of debt services and rules that provide for sanctions arising from non-compliance.

In parallel to this, the Brazilian Constitution fixes the exclusive competence of the Federal Senate to deal with global limits and conditions for credit operations, for guarantees in credit operations, and for the amount of bonds emitted by the states, the Federal District and the municipalities. The Federal Senate does not have competence, though, for legal innovation in matters of credit and debt operations, changing, for instance, concepts, constituent elements and attributes, having only the role of addressing "global limits and conditions" (Arellano, 2020: p. 122). Still, the emergence of the Senate as a key player in managing the external credit of the nation is a recognition of the dis-balances that might appear when the national credit is not handled properly in a federal state, as the history of the United States (Desmedt, 2014) and also that of Brazil show.

The resource to external credit is a mechanism for a State to use external savings to develop the economic and social infrastructure necessary for development (Da Rocha, 2017). This is especially relevant to countries that have not completely gone through a phase of capital accumulation sufficient to sustain economic growth in the long term. The risk of external debt, however, comprises the need to generate foreign currency in the future to pay for the services of this debt. In this scenario, when resources mobilized from abroad are not applied to productive investments, generating additional internal production capacity, reducing the need for imports and expanding the capacity to supply goods for export, the likelihood of external dependence and balance of payments crises become greater (Prebisch, 1962).

This is even more relevant considering that, as emphasized by François Chesnais (1996), an important aspect of globalization at the end of the 20th century would be its concentrated nature. With this in mind, it is not always correct to say that greater freedom of capital results in greater democratization of investments or better opportunities of external resources for investments in developing countries. Throughout the second half of the 20th century and especially in the 1970s, following the recycling of "petrodollars" in the "eurodollar" market, the world witnessed an unprecedented rise in the debts of underdeveloped countries, including Brazil. At the end of the 1970s, however, high inflation in central countries, resulting from the abandonment of the dollar-gold monetary regime adopted since Bretton Woods, was responded to by rising interest rates in these countries, changing financing conditions throughout the world and worsening the social consequences of the lack of domestic savings in some emerging and underdeveloped countries (Valdez & Molyneaux, 2016).

Another relevant aspect of globalization, still in the reasoning of Chesnais (1996), is the apparent detachment of financial assets in relation to the real assets of the economy, the latter being the ones responsible for generating employment, income, and well-being for the population. This detachment is well observed in the 2008-2009 global financial crises, that had its origins in the American subprime real estate market but spread globally because of varied complex interconnected financial instruments that only remotely connected to the original real estate operations (Paulson Jr., Bernanke, & Geithner, 2019).

On the other hand, external credit, although sometimes presented as something negative, also presents clear positive points to be taken into consideration in the capital's composition structure of a public entity interested in financing its deficit. Among the benefits of external credit in relation to other financing possibilities, there is the fact that external credit is less likely to result in the crowding-out effect (Drazen, 1998), while it eliminates the temptation for the government to generate inflation to reduce the real value of the debt stock. Thus, it can be said that, to some extent, external credit is an inducer of greater monetary discipline, especially if one considers that greater inflation, according to the theory of international price parity, produces exchange rate depreciation (Krugman & Obstfeld, 2010), which when there is debt denominated in foreign currency, will cause an increase in the total debt of the public entity. Therefore, the existence of external debt will represent a disincentive to government financing its expenses through the inflationary issuance of currency (Beaugrand, Loko, & Mlachila, 2002).

In Brazil, the competence of the Federal Senate to deal with public debt is exclusive, which excludes the competence of any other entity to deal with the matter (Ataliba Nogueira, 1973: pp. 192-193). This competence refers to the definition of limits and conditions for credit operations, besides the approval of external credit operations, and cannot go as far as establishing general rules on credit operations, as they are specific competences of the National Congress. The risk that the exclusive competence of the Senate could be usurped by other bodies that, under the pretext of determining accounting standards (Secretary of National Treasury) or under the pretext of monitoring compliance with current standards (Court of Accounts), though, cannot be underestimated.

The Federal Senate's competence to impose limits on funded debt and to allow external credit operations raises an interesting question: what would be the sanction in the case of a public debt origination in non-compliance with the rules established by the Federal Senate? Pontes de Miranda (1969), referring to the Federal Constitution of 1967, with effects of Constitutional Amendment no. 1/69, states that such debt would be non-existent and could not generate effects. On the other hand, Ataliba Nogueira (1973), writing about external credit operations, states that, as it is, in his opinion, a private contract (in opposition to a public contract or "contrato administrativo"), it would subject the Union, the state or municipality to its terms and conditions, but also to legal sanctions for

non-compliance with the conditions imposed by the Federal Senate. Ataliba Nogueira (1973) thus argues by distinguishing between the public domestic law effects expected from the contract and the effects arising from private international law. The effects of public domestic law may be impeded because of non-compliance with the limits imposed by the Senate. However, the obligation from the perspective of private international law must remain in force (Ataliba Nogueira, 1973: p. 187).

The situation changes, however, in the regime currently in force, considering what is contained in article 33, § 1, of Complementary Law no. 101/2000, which provides that the obligation assumed in breach of this law is null, resulting in the loss of interests and fees by the financial institution that fails to comply with the rules established therein (among which is the need for previous Senate approval for an external credit operation). A loan agreement not compliant with the Federal Senate rules, thus, would not be enforceable by a Brazilian judicial court.

As argued, the Federal Senate cannot go too far as to prohibit public entities from contracting foreign debt. If, on the one hand, the participation of the Federal Senate reflects the constitutional legislator concern that public debt only occurs in the country's interest's for regionally balanced development, as the Brazilian Supreme Court has already stated, the standards displayed in the Federal Senate Resolutions cannot impose unreasonable limits, which would imply in true withdrawal of the power of the Union, the states and municipalities to contract public loans aimed at achieving their objectives.

For the present paper, the most important issue regarding the conditions imposed by the Federal Senate is related to its competence to authorize external financial operations of interest to the Union, the states and municipalities.

Brazil's first republican Constitution, in 1891, allowed states and municipalities to assume external financial commitments without any limitations (Scaffi, 2014: p. 42). This lack of coordination led to a series of fiscal and, more broadly, economic difficulties for the country. For this reason, the following Constitutions prohibited this free recourse to external operations, a prohibition that remains to this day (Oliveira, 2004: p. 210), requiring previous authorization from the Federal Senate to take external credit.

The basic issue of identifying an external credit operation is not a settled issue, though. The literature describes three traditional ways to identify a debt as external. First way focuses on the currency in which the debt is issued, whether national or foreign currency. The second traditional way of identifying external debt considers the creditor's residence, whether in the country issuing the debt or abroad. Finally, the third criterion considers the jurisdiction in which the debt was created and, therefore, the set of laws applicable to the relationship: whether national laws or the laws of other countries.

Panizza (2008) argues that the first method is not appropriate, as it is not uncommon for debts to be issued on the domestic market in foreign currency or corrected by the variation of some foreign currency. The second differentiation

method becomes difficult to be effectively monitored in increasingly integrated markets, considering the existence of a dynamic secondary market for public securities, in which residents and non-residents can negotiate with the debt of a certain country. Therefore, the third method would remain, which points to the jurisdiction in which the debt was created.

In Brazil, several methodologies are mentioned in the literature, depending on the goal of the classification, whether economic statistics or other reasons. Unfortunately, fiscal rules in Brazil are not entirely clear on the subject, raising questions regarding whether previous authorization from the Federal Senate should be required for different financial operations. Banco Central do Brasil (2019: p. 24), aligned with International Monetary Fund (IMF) recommendations, considers as external public debt "debt securities traded on the domestic market held by non-residents, denominated and settled in reais". On the contrary, Silva & Medeiros (2002: p. 104) argued in 2002 that Brazil followed a classification method based on the currency in which the debt is supposed to be liquidated, not on the residency of the creditor. Catapani (2014: pp. 68-69) uses a combination of the place of issuance criteria and the reference currency to identify a credit operation as internal or external, as he understands operations launched in a foreign country, for which payment occurs in foreign currency, are external. In case of conflict between both criteria, however, the author defends that the place of issuance should prevail, as this would place emphasis on the normative power arising from that issuance. Andrade (2012) argues that article 3 of Resolution No. 43 of the Federal Senate honors the concept of an external credit operation as one signed with a creditor domiciled abroad, given that the aforementioned rule would refer to it as a "credit operation, for this Resolution, commitments made with creditors in the country or abroad." Alternatively, Assoni Filho (2007) states that the best criterion to be adopted is the location of payment. The same understanding is supported by Oliveira (2004). This understanding, though, argues Andrade (2012), would coincide most times with the criterion of the creditor's place of residence.

The Brazilian Constitution gives the Federal Senate the power to authorize external credit operations, so that it ensures, besides the federative balance in access to foreign resources, also control and monitoring of the commitments assumed by the nation with foreign nations. In this context, at the time of issuing, if the first subscriber is resident abroad, the national entity will experience an increase in its net assets and also in its liabilities abroad. As the interest in the operation accrues and is paid, the national entity will suffer a reduction in its net assets abroad corresponding to the payment of interests, which will be transferred to the interests account in the balance of payments. It appears, therefore, that financial relations abroad are affected by credit both at the time of issuance and at the time of payment. Hence, it seems correct to state that, in a legal sense, the external credit operation is the one which is conducted with a creditor residing abroad whose payment occurs also abroad in foreign currency, this being

the criterion that best fits the exchange rate system in force in Brazil, based on Law no. 4131/1962 and also the Brazilian legal rules for identifying an international contract in the international private law perspective.

This is the opinion of Gödel (2000), for whom:

> International loan contracts as direct loans are known as "4131 Loans", "4131 Law Contracts" or even, "4131 Operations". Direct loans are understood to be loan agreements whose purpose is to loan money obtained from an individual or legal entity, resident, domiciled, or headquartered abroad by a Brazilian legal entity, which can either be an entity in the sector public, as a private sector entity. (…)
> In loans 4131, the operation is performed directly with the foreign lender… There is no intermediation through a national financial institution or other body. (Our translation from Portuguese)

The legal criteria that is adopted in Brazil, even if it is connected to the international mainstream standard, is criticized given the increasing integration of markets, which, according to Panizza (2008), turns irrelevant the distinction between external and internal debt, considering the perception that it is not the external or internal nationality of the credit holder that makes the debt more or less risky, but the possibility of a mismatch between the value of the currency and the maturity periods of the debts. We do not fully agree with this perspective, though. It is indeed the currency that sets the exchange risk, but the main purpose of the control of foreign indebtedness is not exchange risk management, but control of the indebtedness of a nation with other nations. It is a sovereignty issue, not simply a financial issue. External debt is different because the creditor is not a subject of the borrower and that has legal implications.

Using external credit, especially in developing countries such as Brazil, has historically resulted from the lack of internal savings, which consequently leads to a low supply of internal credit to meet demand from both the government and the private sector. With external credit, the discussion about the applicable legal regime becomes legally complex, entering the field of international law. The main question, in this context, will be to define whether the norms of public international law will be applied, especially those related to non-submission of a government to a non-domestic court, except voluntarily, or whether the norms of private international law will be applied, which will imply there is also a need to identify the applicable rules, whether national or from another country, as well as the competent jurisdiction to process and execute any sentence resulting from an agreement involving the international loan (Gordillo, 2013: pp. 421-422).

The loan contract will be governed by public international law when it is a contract signed between sovereign states or between them and a public international institution. In the latter case, Gordillo (2013: p. 423) argues that the internalization of the treaties establishing the international organization, when the

state entity is party to such treaties, would be enough to ensure its adherence to any rules arising from them relating to the regime of credits granted.

For the remaining cases, considering the application of private international law rules, the election of a foreign jurisdiction for the international loan contract, as well as the establishment of foreign rules to govern the obligations arising from the contract, is a protection for the foreign lender against the possible opportunism of the State in modifying its legislation, to facilitate the non-payment of its debt (Head, 1996: p. 216). It is also a way of reducing legal transaction costs, given the greater stability of the rules and jurisprudence of traditional international financial markets (Acemoglu & Johnson, 2003; Qian & Strahan, 2005), such as London or New York.

Therefore, external debt involves a full spectrum of considerations that are not present when engaging with internal debt agreements. If, on the one hand, external debt may present in some cases advantages over internal debt, it is also a fact that external debt implies an increase in risks related to the management of external accounts, with repercussions on the whole economy. This justifies a different approach for the control of external debt in national fiscal rules in comparison to the rules applicable to internal debt.

In this scenario, it is important to develop a theory for defining in a precise manner the legal regimen for contractual operations that have the potential to "nationalize" what could otherwise be considered external credit operations. This is necessary to determine which elements must be present in order to fully comply with Brazilian fiscal rules in the case of public debt instruments. In the next section we develop such a theory within the realm of the so-called "on-lending agreements".

3. On-Lending Agreements in Brazilian Commercial Law

In international finance, an on-lending agreement involves a series of financial transactions where funds are transferred from an original lender through an intermediary to a final borrower. This process is common in situations where international financial institutions, such as the World Bank, the IMF, or regional development banks, provide loans to countries or large national financial institutions. The recipients of the resources then lend the received funds to smaller entities within the country, such as government departments, municipalities, or private sector companies, for specific projects or purposes.

The structure of an on-lending agreement typically involves several key components and steps, such as 1) the original loan agreement; 2) the intermediary; 3) the on-lending agreement; and 4) the use of funds.

The process usually begins with an original loan agreement between an international financial institution and a sovereign state, or a large entity. This loan is frequently provided at concessional or market-based interest rates and is intended for development projects or to support specific sectors of the economy. The intermediary in an on-lending agreement is often a government or a gov-

ernment agency of the borrowing country, but can also be a financial institution allowed to operate inside the recipient's country. This intermediary receives the funds from the international financial institution under the terms and conditions specified in the original loan agreement. The intermediary then uses those funds as a source for signing independent loan agreements with final borrowers, which can be sub-national entities like state governments, municipalities, or private sector companies. These agreements specify the terms under which the funds are to be used, the interest rates, repayment schedules, and other conditions. The terms may be similar to or differ from those of the original loan, depending on the intermediary's policies and the project's specifics. The funds are typically earmarked for specific projects, such as infrastructure development, healthcare, education, or environmental conservation.

The final borrowers implement the projects and ensure that the funds are used efficiently and effectively. They are also required to repay the intermediary according to the terms of the loan agreement. The intermediary, in turn, is responsible for repaying the original lender (the foreign financial institution) according to the terms of the first loan agreement. This structure ensures that the international financial institution funds are used for their intended purpose while allowing the intermediary some flexibility in managing internal priorities and capacities.

On-lending agreements are crucial for international finance as they facilitate the flow of funds from global institutions to local projects, helping to promote economic development and improve living standards in less developed countries. However, they also require careful management and oversight to ensure that the funds are used effectively and that all parties meet their financial obligations.

Since the foreign financial institution's contractual relationship in a typical on-lending agreement is with the intermediary financial institution and not with the final borrowers, the foreign institution rarely has a direct legal claim against the final borrowers. If the final borrower cannot repay the intermediary according to their loan agreement, it does not change the obligation of the latter regarding the foreign institution. In this sense, on-lending agreements differ substantially from syndicated loans or loan participations in which there is also a plurality of creditors, but all of them are directly bonded by the same loan agreement to the final borrower.

This structure manages and mitigates the risks associated with international lending, allowing international financial institutions to support development projects indirectly without managing many small loans to various entities within a country. It also places the responsibility for selecting, monitoring, and ensuring the success of the final projects on the intermediary, which is presumed to have a better understanding of local conditions and needs.

There is some discussion in the literature on what is the exact legal nature of on-lending agreements in Brazil. Salomão Neto (2014), for instance, distin-

guishes between on-lending operations held domestically by financial institutions with national development banks in Brazil and international operations in which national financial institutions raise funds abroad only to lend those funds to national companies (or public entities). The author argues that transfer operations between national financial institutions and national banks (such as "operações de repasse" with BNDES/FINAME) should legally be considered commission contracts, as follows:

> We should note that in BNDES/FINAME transfers, unlike what occurs in external resource transfers, we have a commission contract between the Agent (the accredited financial institution) and BNDES and a loan contract between the Agent and the final borrower of the resources. It should also be noted that the Agent guarantees the final borrower with del credere, as required by article 52, I, of the Provisions Applicable to BNDES Contracts. In fact, it is the mention of this del credere clause, a typical figure of the commission, that makes it possible to identify the transfer of BNDES resources to the commercial commission.
>
> The aforementioned understanding, that between BNDES/FINAME and the Agent there is a commission contract, does not contradict the definition of article 693 of the Civil Code, according to which the "commission contract has as its object the acquisition or sale of goods by the commissioner, in his own name, to the account of the principal". We must understand that the rules of this figure can also apply, because of the principle of autonomy of will, to contracts in which the commission agent performs business other than buying and selling on behalf of the principal, such as the granting of loans, as in BNDES/FINAME resource transfers. (our translation from Portuguese)

Still, the same author defends that international on-lending operations are built over two distinct contracts that should be interpreted isolated from each other, not allowing the use of the colligated contracts theory to bind both agreements:

> The legal nature of operations involving the transfer of funds raised abroad is controversial. Under the rule of the old Commercial Code, there were those who argued that they are commercial commission contracts (article 165 et seq. of the old Commercial Code) between the lender abroad and the national financial institution. In this sense, the original operation of transfer by the originator of the resources to the transferring bank would be a simple provision to loan resources to the final borrower through commercial commission. In the mercantile commission, however, the commission always acts on behalf of the principal. This does not happen with transfer, which occurs within the framework of the economic activity of the transferor, and not of the initial originator. There are, therefore, two distinct credit contracts in funding and on-lending.
>
> Besides the attempt to fit the transfer of funds raised abroad into the old

> mercantile commission, attempts have also been made to explain such a transaction through the theory of contractual coalition. According to this theory, there would be a diffuse “connection” between the loan contract made between the national financial institution and the foreign lender and the loan contracts made by the former with the resources raised abroad. Simply put, for the theory of contractual coalition, two or more contracts, perfectly distinct from each other, would maintain a “functional connection” in the existence of a nexus of interdependence and derivation. With transfer of funds raised abroad, the loan contracts performed in the country would be “derived” from the contract conducted abroad. Because of the contractual coalition, all contracts performed in the country would depend on the loan contract between the national bank and the foreign bank, so that if, for any reason, this contract were to be ended, the same should occur with the transfers made by the National Bank. It is difficult to accept this theory. Only from the contractual scheme of the transaction could the rules on the simultaneous end of both obligations come from, and not from the doctrine of related contracts. In the absence of such a provision, there would be no way to impose the contractual coalition and its effects, such as the simultaneous termination of contracts.
>
> The legal nature of transferring resources raised abroad is actually quite simple. Such an operation covers at least two distinct loan contracts. The first of them is performed between the national bank and the foreign bank and another (or several others) conducted between the national bank and its customers, using the resources provided by the first contract. (Salomão Neto, 2014: pp. 203-204, our translation from Portuguese)

The independence of the two contracts in an international on-lending agreement is also emphasized by Gödel (2000):

> Loans contracted between a foreign creditor and a national financial institution are independent of transfers contracted between a financial institution and a legal entity, including dates and payment methods.
>
> (…)
>
> Although the transfer occurs to a national company and the national financial institution becomes a creditor in Brazil, the original credit remains in the ownership of a person domiciled abroad. The creditor domiciled abroad is the holder of credit whose payment must be made in foreign currency, even if the obligation may be enforceable in the country. However, despite this ownership, the two contracts are not confused, nor do they depend on each other, that is, the loan contract signed with the creditor domiciled abroad must be fulfilled, regardless of whether the amounts transferred, contracted with the national borrower, have been paid or not. At the time of execution, therefore, the two contracts remain absolutely independent. (Our translation from Portuguese)

The same idea is present in an important precedent of the Brazilian Supreme Court, as one can conclude from the following passage of Extraordinary Appeal (RE) 103.611-7-SP:

> The expression transfer, so often mentioned, has a much more restricted meaning than what the appellants intend to lend it; it only means that it is about resources obtained in the international financial market (in foreign currency), obligatorily distributed, in the country, by the Central Bank, to the financial institutions that will apply them in the domestic market; however, neither the foreign financial institution nor the Central Bank appears as a creditor. A creditor is purely and simply, the national financial institution that invests the funds in the domestic market. The relationship of this financial institution with the Central Bank, and between the Central Bank and the foreign banker, constitutes res inter alios for the borrower, a national company. (Our translation from Portuguese)

In fact, even if there is a link between contracts (in terms of financial conditions and even an express mutual reference) in international on-lending operations, that is not enough to consider them as colligated contracts. This is because the main characteristics of colligated contracts is their common destiny and their economic unity, in the sense that the extinction of one of them results in the extinction of the other, which does not happen in ordinary on-lending operations, where we can identify two distinct and independent loan operations, even if economically connected. In the words of Miragem (2023):

> What characterizes connectedness is the fact that it implies effects external to the contract, so that the fate of one contract encompasses the others. Here, it grounds the effectiveness of the contract vis-à-vis third parties, which can be seen both in cases of invalidity and ineffectiveness of the contract—which could attract others—, as well as the hypothesis of resolution itself as a way of extinguishing the link of a contract, but whose same effects can be projected onto other contracts that are connected to it. (our translation from Portuguese)

Emphasizing the need for economic unity among colligated contracts, that the plurality of contracts is simple components of a single economic operation, Kuyven et al. (2016) argue that

> Each of the contracts that make up the set, despite being able to be recognized separately, must make up a unified economic operation, which overlaps these contracts and, therefore, is supra-contractual. Each contract, despite its specificity and identity, performs the function of a component of a unified and supra-contractual economic operation. (our translation from Portuguese)

Whether they are merely autonomous contracts that are just linked economically, or they are commission contracts, the fact is that both opinions have the

same legal consequence regarding the legal treatment to be given to the final loan agreement in Brazil: it should be treated not as an external credit operation but as an internal credit operation although the funding for the second loan agreement came from a foreign institution.

That is even independent on the currency of the second contract between Brazilian parties, since the legislation accounts for the possibility of a contract between Brazilian parties in foreign currency "in the situations foreseen in the regulations published by the National Monetary Council, when the stipulation in foreign currency can mitigate the exchange rate risk or increase the efficiency of the business" (Law no. 14,286/2021)

Hence, if a domestic financial institution acts as an intermediary for a Brazilian borrower, lending in the same foreign currency it has previously raised funds abroad, it is not, by itself, sufficient to turn the contract into an external credit agreement. This should be evident considering that, in this case, the second operation does not entail any change in the international investment position statement (IIP) of the country, since it is an operation between national parties. If that is the case, one must recognize a fortiori that the simple existence of an exchange rate compensation clause is also not enough to transform a loan contract between nationals into an external credit operation.

This opinion is confirmed by the fact that Resolution BCB no. 278/2022, that regulates the Law no. 14,286 in Brazil defines the expression "external credit" as a

> financial commitment, even if the resources do not enter the country, assumed by a resident whose creditor is a non-resident due to: 1) direct loan; 2) issuance of securities on the international market; 3) issuance of private placement securities in the domestic market; 4) financing; 5) financed import of goods or services; 6) advance receipt of exports, understood as the raising of external resources in advance for future exports of goods or services that will be conducted in payment of the debt contracted; or 7) external financial leasing, understood as the operation in which a non-resident legal owner of an asset (lessor) substantially transfers all the risks and advantages of ownership of the asset to a resident (lessee) upon payment of installments; (our translation from Portuguese)

By doing so, it differentiates external credits from on-lending agreements ("operações de repasse do exterior"), defined as:

> a contract linked to raising funds abroad, through which a national financial institution grants credit to a resident through transferring identical cost conditions of the contracted debt (principal, interest and ancillary charges), including applicable taxation (our translation from Portuguese)

In this context, one should consider the fact that Brazilian law considers as a domestic company a company that is both incorporated according to Brazilian law and has its administration based in Brazilian territory. In the words of Do-

linger & Tiburcio (2016: p. 261):

> the nationality of the legal entity in terms of our Private International Law is characterized by the country of its incorporation; To be considered as Brazilian, the company, besides being incorporated in our country, must establish its administrative headquarters here.
> Therefore, a company incorporated in Spain, which establishes its registered office in Portugal, will be considered by our DIP as a Spanish company. But a company incorporated in Brazil that does not establish its registered office here will not be considered Brazilian, which takes us, in a further step, to understand that our authorities will not register a company in Brazil that does not establish its registered office in Brazilian territory. (our translation from Portuguese)

Hence, with an on-lending operation with a national financial institution acting as an intermediary in compliance with Brazilian banking law, the second loan agreement, that is, the contract between the intermediary and the final beneficiary (borrower) cannot be considered legally as an external credit operation.

4. Consequences of Nationalization of External Credit Agreements

As mentioned, on-lending agreements are a frequently used instrument for allowing international resources to become available to national borrowers. Because of how on-lending agreements are put together, the loan agreement between the intermediary domestic financial institution and the final borrower cannot be considered an external credit operation. Now, that raises the question of what that implies for the compliance with the rules regarding public indebtedness control, as presented in item 2 of this paper.

As presented earlier, the literature gives two different interpretations for the legal nature of on-lending agreements: either they can be seen as commission contracts between the international financial institution and the intermediary or they can be seen as two different loan agreements that cannot be legally bound, even if economically they work in tune (Salomão Neto, 2014).

One of the main characteristics of the commission contract is that it is used to replace the mandate contract when the mandate is deemed to be inconvenient for commercial purposes. In fact, this was the main historical reason the commission contract was developed in the first place, as explained by Theodoro Júnior (2011, item 22):

> Its peculiarities allowed merchants to hire in distant places and overcome the difficulties related to accurate information about people and local habits and the risks of entrusting functions and responsibilities to strangers. The principal could also enjoy the credit of the local merchant, that is, the commission agent.
> This is how the figure of the commission emerged, which allowed the mer-

> chant to entrust a third party with the mission of performing acts of commerce, concluding business or contracting, for his benefit or on his behalf, but in the name of the commission agent himself, without obliging the principal to third parties, as would happen if he had to use the mandate.
> On the other hand, hiring a commission agent represented a reduction in costs and expenses for the principal and often circumvented the prohibitive rules on trade by foreigners. (our translation from Portuguese)

To make clear the distinction in Brazilian commercial law between the two different contracts, still in the words Theodoro Júnior (2011, item 22):

> In both contracts [commission and mandate], therefore, there is business management for the benefit of others. The distinction between them is based on the fact that the agent always contracts in the principal's name, while the commission agent always negotiates in his own name. The principal is the party to the contract in whose behalf the agent signs. The commission agent, and not the principal, is the party to the transaction arranged in the principal's interest. Although economically interested in the operation's result conducted by the commission agent, the principal is, from a legal point of view, "completely foreign to the operations and contracts signed by him (commissioner) with third parties". (our translation from Portuguese)

The same opinion is presented by Warde Júnior (2011), for whom:

> Such independence means that the commissioner entering, in his own name, a contract with the third party is personally obligated. The obligations assumed and rights acquired fall within the sphere of the commissioner, who transfers the desired benefit to the principal, as determined by the internal legal transaction. However, as the transaction is concluded in the name of the commission agent and on behalf of the principal, representation being inadmissible, in the event of default by the principal, the person obliged and responsible for fulfilling the agreed legal duty is solely the commission agent. In the opposite situation, that is, if the third co-contractor is in default, he can only be sued in court by the commissioner. (our translation from Portuguese)

This distinction is of crucial importance, because, as recognized by Head (1996: p. 225) "private sector operations do differ in important respects from public sector operations" and, because of this "issues of governing law and validity for purposes of public sector transactions would best be clearly articulated". If this is true, there is no point in subjecting a contract between a foreign financial institution (even if the foreign institution is a multilateral development bank) and a private intermediary to the same legal framework (restrictions and conditions) applicable to a direct agreement between an international foreign financial institution and a public entity.

On this ground, it is possible to state that an on-lending agreement between a foreign financial institution and a private Brazilian institution, even if the final beneficiary is a public Brazilian entity, is not subject to the same requirements applicable to a direct loan agreement between a foreign Brazilian institution and a public Brazilian borrower. It is subject to international law principles, among which the "principle of autonomy of will" stands out. In this sense, Araujo (2020) explains that

> [s]tudies on international contracts are part of the special part of the DIPr [private international law], and the principle of autonomy of will in determining the applicable law is one of the most important topics. At the international level, it can be said that there is a consensus that it is up to the parties to choose the law applicable to an international contract, enshrining the principle of autonomy of will. The Hague Principles on the Choice of Law Applicable to International Commercial Contracts accurately reflects the relevance with which the matter is treated by a considerable number of States. (our translation from Portuguese)

It is important to notice though that, if the foreign counterpart is a multilateral development bank, it is likely that the rules to be applied to the contract with the national intermediary institution are not originated from private international law principles, such as the "autonomy of will" principle, but from public international law, as demanded by the treaties and customs regarding those entities, which is well explained in Head (1996).

Still, considering that the contract between the foreign financial institution (multilateral development bank or not) and the intermediary institution is legally isolated from the contractual relation that is to be established between the intermediary and the final borrower, this means concretely that, in an ordinary on-lending agreement, the authorization of the Federal Senate is unnecessary, unless the intermediary institution is itself a public entity in the view of the applicable fiscal rules. In parallel, it is important to notice that the loan agreement between the national intermediary lender and the public entity in Brazil, specially when signed in Brazilian territory, cannot be considered an international contract (nor either an external credit operation) and, thus, is not subject to international law, being ruled entirely by Brazilian law provisions, as prescribed by article 9 of Decree-Law no. 4.657/1942.

In this sense, Baptista (2011: p. 29) explains, basing his argument on the revoked Decree-Law no. 857/1969, that

> for the Brazilian law, [the international contract] is a contract which, having elements that allow it to bind it to more than one legal system, has as an object an operation that implies a double flux of goods through the borders, or derives directly from such a contract. (our translation from Portuguese)

The distinction between a purely local agreement (internal credit operation) and an international agreement (that may give rise to an external credit opera-

tion) can have several implications still, since Qian and strahan (2005) have shown that

> interest rates on loans to unrated borrowers, where local lenders are dominant, do not reflect the costs of using the courts (legal formalism) because local lenders usually re-contract or workout loans privately. In contrast, interest rates to rated borrowers increase with the costs of using courts because foreign lenders expect to use courts for defaulted loans.

In this context, the classification of the loan agreement between the domestic financial institution and the public sector borrower, in an on-lending operation, as an internal credit operation (in opposition to an external credit operation) is consistent with the formal and informal instruments that are available to the domestic intermediary to persecute its credit in case of default, which are not available to the foreign lender. Additionally, it correctly considers the greater ability that the domestic financial institution has to assess the risk of the borrower compared to the foreign lenders (Qian & Strahan, 2005). On-lending operations can thus act as an instrument for handling weak domestic contractual institutions that could otherwise jeopardize the access to foreign credit, following the lesson of Acemoglu & Johnson (2003), for whom

> …contracting institutions affect the form of financial mediation, but have less effect on economic growth, investment, and the overall level of financial development. It seems that society can function in the face of weak contracting institutions without first-order economic costs, but has a much harder time dealing with a significant risk of expropriation from the government or other powerful groups. Our interpretation, consistent with the simple model we use to highlight the distinction between contracting and property rights institutions, is that contracting institutions affect private transactions and create ex post transfers between parties (for example, when lenders face large costs of collecting on their loans from borrowers). Private contracts or other reputation-based mechanisms can, at least in part, alleviate these problems. For example, when it is more difficult for lenders to collect on their loans, interest rates increase, or banks that can monitor effectively will play a more important role, or reputation-based credit relationships will develop. Private contracting and alternative financial arrangements therefore limit the effects of contracting institutions and legal formalism.

On top of that, the reconnaissance of the legal distinction between on-lending operations and simple external loan agreements can have practical consequences regarding the decision of public entities by one type of contract or the other. This is because the requirement of Senate authorization for external credit operations in Brazil have been shown to transform the otherwise simple process of contracting a loan agreement into a long and complex process in which politics and informal bureaucratic mechanisms can frustrate a subnational government

from signing a credit operation within a reasonable timeframe. In this sense, on some occasions, the tradeoff between time until signing, on the one side, and the total cost of the operation, on the other, might favor the choice of an on-lending agreement instead of a direct external loan agreement.

5. Conclusion

The resource to external credit in a federal country requires a careful consideration of the interests of populations of different states, aiming at achieving inter regional balance and the reduction of inequalities. Brazilian history, with the requirement of authorization from the Federal Senate prior to the signing of external financial operations, since the 1934 Constitution and up to the Constitution now in place, is an example of an institutional mechanism to achieve this goal.

Nevertheless, not all financial operations that involve raising money from abroad are subject to the Federal Senate authorization, since this is only mandatory for external financial operations involving public entities. In this sense, the present paper has shown that the so called "on-lending operations" can "nationalize" credit operations, avoiding the otherwise cumbersome process of obtaining the required waivers and approvals, with special mention to the Federal Senate authorization. This is the case when the "nationalization" of the foreign capital is done by a domestic private financial institution that later signs a new loan agreement with a subnational public institution.

Finally, it has been showed that on-lending operations, apart from having the consequence of dispensing with the Federal Senate authorization, can be justified because they are an instrument for reducing information asymmetries between foreign lenders and domestic borrowers regarding the financial stance of the borrower and institutional conditions within the borrower's country for enforcing the agreement if necessary. As such, on-lending operations can enhance the availability of foreign capital for financing national development, especially in developing countries like Brazil.

Conflicts of Interest

The authors declare no conflicts of interest regarding the publication of this paper.

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