Development Challenges in Brazil

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José Luiz Rossi

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OPTIONAL: Type address for correspondence

OPTIONAL: Type Authors name and eMail

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Jose Luiz Rossi

Medium-Term Economic and Social Trends

The Brazilian economy is experiencing a cyclical recovery from one of the deepest recessions in its history. Real GDP per capita fell approximately 10 percentage points between 2014 and 2016 as long-standing macroeconomic imbalances worsened (Figure 1). Widening fiscal deficits and high inflation impacted country risk, generating uncertainty and delaying the recovery. As risks started to be reined in through monetary policy tightening and the pursuit of a gradual fiscal adjustment, the cyclical recovery strengthened. The Brazilian economy grew 1.0 percent in 2017, and markets project growth at around 2.5 percent for 2018. Household consumption and investment are playing an increasingly significant role in the process. However, sustainability of public debt remains dependent on the approval of additional structural fiscal reforms, so the task of taming key macroeconomic risks is still ongoing.

Before the recession, Brazil had experienced a decade of substantial reduction in poverty and inequality, including a significant fall in extreme poverty. Between 2002 and 2013 more than 15 million people escaped extreme poverty.

Medium-Term Economic and Social Outlook

Medium-term growth prospects face uncertainties. Markets forecast a long-term growth rate of 2.0%, yet this forecast assumes that a sufficiently strong set of measures—most notably social security reform—are put in place to ensure fiscal sustainability, which is crucial for a more stable growth path.

Risk Factors

External risk factors weigh on the medium term. The evolution of commodity prices has been more favorable during 2017, but it is unclear whether this trend will continue in the near future given the shifting Chinese economic model and other global developments in trade policy. In addition, monetary policy in advanced economies can trigger capital flows amidst higher global interest rates, producing macroeconomic fluctuations in emerging markets. While Brazil's public debt is mostly domestically financed, there are other channels through which turbulence in international financial markets can produce negative shocks, particularly given the macroeconomic adjustment process still underway.

Domestically, the medium-run growth outlook is fully dependent on the country's ability to advance in its policy agenda on both the macroeconomic and microeconomic levels. The fiscal sector remains the main area of macroeconomic vulnerability. Particularly, the evolution of the social security system and its impact on public debt dynamics hold implications for development. On the microeconomic front, it is critical to lower production costs, improve the quality of goods and services and facilitate reallocation while instilling greater competitive pressure across the economy to boost productivity.

Development Challenges

Improving Brazil's competitiveness is crucial to reverse recent negative trends and support economic development. The Global Competitiveness Index (GCI) 2017–2018 (see World Economic Forum, 2017), which tracks the performance of 137 countries, shows Brazil ranked below all other BRICS countries, in the 80th position. The index further shows a steep fall from the 48th position (out of 144 countries) achieved in the 2012-2013 evaluation (see World Economic Forum, 2012). Key areas for improvement are the business environment, integration, infrastructure, and public-sector reform.

Brazil has an unsatisfactory business climate that reduces competition and productivity. In the *Doing Business 2017* report (World Bank, 2017), the country placed 123rd out of 190 countries. According to this report, it takes almost 80 days to start a business in the country, much higher than the worldwide average. In addition, Brazilian markets are heavily regulated in comparison to the OECD benchmark. These are concrete examples of factors that stifle productivity growth, holding back investment and innovation.

The quality of Brazilian infrastructure is precarious. According to the World Economic Forum (2015), Brazil ranks 123rd out of 140 countries in terms of quality of overall infrastructure, well below the average of countries with a similar level of socio-economic development. Brazil ranks 121st in quality of the roads, 98th in railway infrastructure, 120th in port infrastructure, and 95th in air transportation infrastructure.

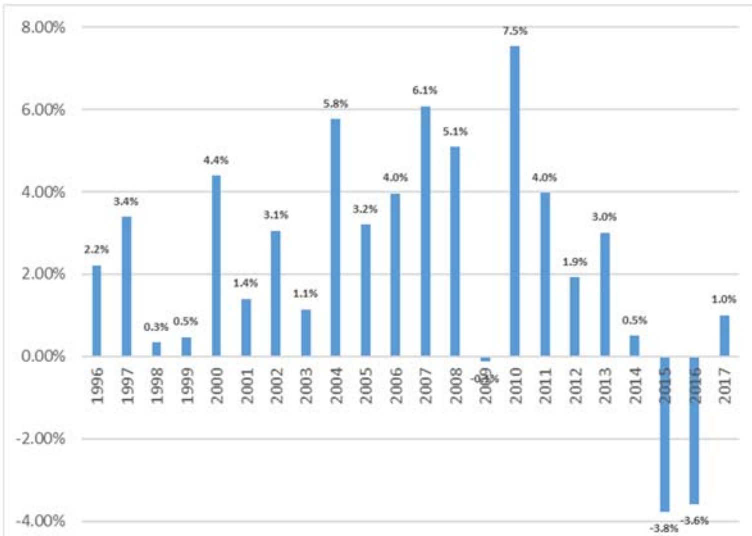
Integration of the Brazilian economy with the world also emerges as another critical pressure point and opportunity for development. Compared with countries of similar size, population and productive environment, Brazil is a relatively closed economy. This is in part because of its abundance in natural resources, but it is also related to the country's set of tariff and non-tariff trade barriers. While tariffs tend to be high in comparison with its counterparts, Brazil is also one of the few countries—whether developed or developing—that has not introduced significant changes in its trade protection system in the last decade. IDB analysis also indicates that Brazil displays lower-than-expected bilateral export performance in large advanced markets where competitive pressures are stronger, suggesting that Brazil could leverage untapped productive potential by addressing critical competitiveness bottlenecks.

Brazil needs a public-sector reform agenda aimed at state modernization and quality service delivery to its citizens. Efforts to spur productivity growth need to be accompanied by targeted public policies which promote equality of opportunities and provide support to vulnerable groups. At the same time, Brazil needs to address the increased demand for transparency and accountability arising from Brazilian society in recent years. This brings to the fore the importance of an efficient public sector capable of formulating, implementing, and monitoring policies. In addition, the reform agenda should contribute to generating the necessary traction to implement structural reforms, some of which produce benefits only with a lag and require political capital to be implemented.

Conclusion

The road towards higher levels of long-term growth and sustainable development is fraught with challenges. However, Brazil has taken important steps towards increasing macroeconomic stability, and it has initiated action on the microeconomic agenda as well. Furthermore, the country enjoys important strengths such as a large and diversified economy and relatively low external debt, backed up by an enhanced policy framework and democratic institutions.

Figure 1. Evolution of Real GDP



Source: IBGE.

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