CREATING OPPORTUNITIES THROUGH PRODUCTIVITY-LED GROWTH

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BRAZIL POLICY NOTES

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DEC

2022
Main Messages

1. The most important obstacle to increasing the incomes of Brazilians is the economy’s low-productivity model, which has underpinned Brazil’s lackluster economic performance over the past two decades.

2. A renewed focus on economic growth is essential if the next administration is to succeed in creating opportunities for Brazilians, especially the underprivileged among them, and reducing their reliance on cash transfers.

3. Decisive reforms will be critical. We propose policy options for accelerating productivity-led growth by: (i) deepening integration and competition through trade; (ii) increasing innovation and technological uptake; (iii) improving the investment climate; and (iv) modernizing infrastructure and its management.
Why focus on productivity when it comes to growth?
Low rates of productivity growth continue to hamper Brazil’s potential for growth

Higher productivity growth is associated with a greater increase in shared prosperity

Negative productivity growth has wiped out the gains from factor accumulation (capital and labor) over the past years

(factor growth contribution (%), selected periods)

- 1997-2005: 2.39
- 2006-2011: 4.30
- 2012-2019: -0.27

<table>
<thead>
<tr>
<th>Period</th>
<th>Capital</th>
<th>Labor</th>
<th>Human Capital</th>
<th>TFP</th>
<th>GDP Growth</th>
</tr>
</thead>
<tbody>
<tr>
<td>1997-2005</td>
<td>1.04</td>
<td>1.43</td>
<td>0.98</td>
<td>-1.06</td>
<td>0.78</td>
</tr>
<tr>
<td>2006-2011</td>
<td>1.14</td>
<td>1.10</td>
<td>1.27</td>
<td>-2.21</td>
<td>-0.39</td>
</tr>
<tr>
<td>2012-2019</td>
<td>1.27</td>
<td>0.27</td>
<td>0.39</td>
<td>-2.27</td>
<td>4.30</td>
</tr>
</tbody>
</table>
Low-productivity has also kept the country behind its peers

Brazil’s productivity growth is low among its peers.

This has caused the catch-up process to stagnate...
GDP per capita at PPP as a share of the US, 1990-2021

... and contributed to annual GDP growth at just 0.53 percent between 2012-19 on average, well below peers.
Agriculture productivity continues to advance, while industry and services stagnated over the past three decades.

Brazil’s sectoral productivity growth compared to India and China between 1994 and 2018.
(cumulative index, 1994 = 0)

The important role of land-based production has contributed to the demand for land and higher deforestation pressures.

Productivity focus (beyond agriculture)
Factor focus (land)

TFP = total factor productivity
What are the World Bank recommendations?

BUILDING OPPORTUNITIES THROUGH PRODUCTIVITY-LED GROWTH

- Increasing integration in global markets through trade
- Improving the business climate
- Promoting innovation and technological adoption
- Modernizing infrastructure (see infra slides)
Global and Regional integration through Trade

Tariffs and non-tariffs measures (NTMs) are also high: they apply to 86 percent of imports compared with 72 percent for other countries.

Brazil is still less open to trade than its peers in both goods and services.

Exports and imports as a share of GDP, % (2021)

<table>
<thead>
<tr>
<th>Region</th>
<th>Exports</th>
<th>Imports</th>
</tr>
</thead>
<tbody>
<tr>
<td>Brazil</td>
<td>19.1</td>
<td>20.1</td>
</tr>
<tr>
<td>Middle income</td>
<td>23.4</td>
<td>24.3</td>
</tr>
<tr>
<td>Low income</td>
<td>31.9</td>
<td>21.6</td>
</tr>
<tr>
<td>East Asia &amp; Pacific</td>
<td>26.4</td>
<td>29.0</td>
</tr>
<tr>
<td>Latin America &amp; Caribbean</td>
<td>28.1</td>
<td>27.6</td>
</tr>
<tr>
<td>OECD members</td>
<td>28.3</td>
<td>28.5</td>
</tr>
<tr>
<td>High income</td>
<td>30.7</td>
<td>31.9</td>
</tr>
</tbody>
</table>

Tariff applied in Brazil and comparable countries, weighted average, 2019z

<table>
<thead>
<tr>
<th>Country</th>
<th>Tariff</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chile</td>
<td>0.43</td>
</tr>
<tr>
<td>Peru</td>
<td>0.73</td>
</tr>
<tr>
<td>Mexico</td>
<td>1.21</td>
</tr>
<tr>
<td>Canada</td>
<td>1.51</td>
</tr>
<tr>
<td>United States</td>
<td>1.59</td>
</tr>
<tr>
<td>China</td>
<td>2.53</td>
</tr>
<tr>
<td>Colombia</td>
<td>2.92</td>
</tr>
<tr>
<td>Turkey</td>
<td>3.13</td>
</tr>
<tr>
<td>South Korea</td>
<td>4.83</td>
</tr>
<tr>
<td>Russian</td>
<td>5.34</td>
</tr>
<tr>
<td>South Africa</td>
<td>5.37</td>
</tr>
<tr>
<td>India</td>
<td>6.59</td>
</tr>
<tr>
<td>Brazil</td>
<td>7.97</td>
</tr>
</tbody>
</table>
Global and Regional integration through Trade: Policy Options

1. Maintaining recent tariff reductions
Brazil recently reduced import tariffs for 1,495 products by 20 percent and reduced all import tariffs below 2 percent to zero as a temporary measure to curb inflation; it is set to expire at the end of 2022. Maintaining these reductions would help keep momentum on growing trade.

2. Advancing regional integration, trade negotiations with the EU and other economies
World Bank simulations suggest that the actual negotiated European Union–Mercosur agreement, including liberalization of tariffs and NTMs, could increase output by 2035.

3. Reducing barriers to cross border trade and investment in services
Reducing restrictions on FDI in modern services can enhance inflows of technology and capital into modern services like ICT, finance, and business services.

Brazil's total gains from services liberalization
(Percentage change with respect to baseline scenario by 2035)

- Real GDP
- Investment

<table>
<thead>
<tr>
<th></th>
<th>Reduction in NTM</th>
<th>Reduction of barriers to FDI</th>
<th>Efficiency Gain</th>
<th>NTM + Efficiency Gain</th>
</tr>
</thead>
<tbody>
<tr>
<td>2035</td>
<td>0.4</td>
<td>33</td>
<td>3.2</td>
<td>6.8</td>
</tr>
<tr>
<td>2036</td>
<td>1.2</td>
<td>9.9</td>
<td>2.0</td>
<td>10.8</td>
</tr>
</tbody>
</table>
The high cost of doing business remains an important challenge for the country.

Brazil has worked to improve its business environment, reduce red tape, and encourage entrepreneurship in the past 15 years, but significant hurdles remain.

The complexity of Brazil’s tax system creates high compliance costs and is the source of several inefficiencies, hampering the country’s growth prospects.

Brazil has one of the most complex tax systems in the world, with over 80 different taxes managed by different levels of government and a multitude of tax benefits and special regimes. The inefficiencies caused by the indirect taxation framework are of particular concern.
Improving the Business Climate: Policy Options

1. Prioritize the reform of consumption taxation in Brazil, replacing several indirect taxes for a standard value added tax.
   The new tax should be non-cumulative, with a broader tax base that includes intangible goods and financial services. Refunds for tax credits should be provided in reasonable time.

2. Replicating good practices that have been proven successful within the Brazilian territory is a first step.
   The good practices identified by Subnational Doing Business in Brazil 2021, among others, can guide authorities to identify areas for reform and existing good practices within the country that can be rolled out more widely, and accompanied by global best practice reforms.

3. Adopting a comprehensive reform agenda, championed by a dedicated actor, working across federal agencies, states and cities, is another key step in a federal setting.
   A coordinated, nationwide reform agenda, pulling together the relevant agencies and committing them to enforceable and actionable goals, could greatly benefit business activities beyond Brazil’s largest cities.
Promoting Innovation and Technology Adoption

Brazil still exhibits substantial lags against other comparator countries in the Global Innovation Index and in terms of key inputs to innovation.

Underperforming innovation policies are part of the reason. Brazil has implemented several innovation policies, most of them involving fiscal incentives, with limited impact on technological adoption and innovation.

Brazil ranks below most peers on the Global Innovation Index, 2020 (the higher the less innovative)…

... And in number of researchers, 2018
Promoting Innovation and Technology Adoption: Policy Options

1. Re-design inefficient innovation policies.
   
The incentives for innovation, research & development provided by the Lei do Bem resulted in underperformance. This program aims to support business Research and Development (R&D). While it has had a positive impact, its performance in boosting R&D intensity is significantly below what would have been expected for such a program.

2. Review in detail the current innovation policies and incentives.
   
The current industrial policy that provides tax exemptions and protection against foreign competition tend favor incumbent large firms, creating conditions for inefficient firms to maintain their position (and market share) without creating pressure for technological adoption or innovation incentives through competition. The revision would help policy makers reorient resources towards more effective programs and remove policies that distort markets.

   
Empirical evidence shows that intellectual property rights (IPR) positively affect the flows of trade in high-technology goods, services and FDI. Brazil could take advantage of future preferential trade agreements (PTA), for instance, the EU – MERCOSUL Free Trade Agreement, to support this agenda.
How has the World Bank been supporting this agenda?
Analytical Studies

1. Brazil 2042
   The report contributes to the debate in Brazil about how to overcome growth and inclusion challenges ahead, over a 20-year horizon.

2. Amazon Economic Memorandum
   The memorandum discusses how to simultaneously provide a pathway to higher incomes for the Amazon States while also protecting natural forests and traditional ways of life.

3. Sub-National Doing Business
   Subnational Doing Business in Brazil 2021 assesses the regulatory environment for small and medium-size enterprises in Brazil’s 26 states and in the Federal District.

4. Jobs and Growth Report
   This book explores the drivers of future employment and income growth. It recommends a change in the relationship between the state and business, from rewarding privileged incumbents to fostering competition and innovation.

Projects and Technical Assistance

1. Trade Facilitation Trust Fund
   This technical assistance explore how to facilitate trade and improve productivity in Zona Franca de Manaus, promoting growth and jobs and allowing a phase out of federal subsidies to the region.

2. Sub-National Productivity TA
   This TA is linked to the sub national Doing Business report. The TA supports subnational governments in preparing reform roadmaps to improve business climate across various states and municipalities (e.g. Pernambuco).
Thank you!