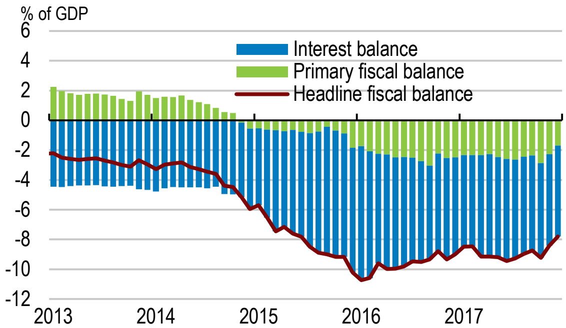
Executive summary

- *Sustaining inclusive growth with further significant reforms*
- *Stronger investment and productivity are key for future growth*
- *Brazil can seize greater benefits from greater global and regional integration*

Sustaining inclusive growth with further significant reforms

Fiscal outcomes have deteriorated sharply



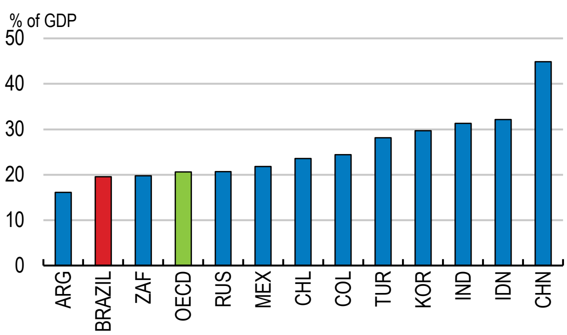
Source: Central Bank of Brazil.

StatLink http://dx.doi.org/10.1787/888933655130

Over the past two decades, strong growth combined with remarkable social progress have made Brazil one of the world's leading economies, despite the long recession that began in 2014 and from which the economy is now slowly emerging. However, inequality remains high and fiscal accounts have deteriorated substantially, calling for wide-ranging reforms to sustain progress on inclusive growth. A better focus of social expenditures towards the poor would reduce inequality and ensure sustainability of public debt at the same time. This will require difficult political choices, particularly in pensions and social transfers. Reducing economic transfers to the corporate sector, in conjunction with more systematic evaluations of public expenditure programmes, will strengthen growth, improve economic governance and limit the future scope for rent seeking and political kick-backs. Fighting corruption will require continuing reforms to improve accountability.

Stronger investment and productivity are key for future growth

Investment is low in international comparison
2010-2016



Source: World Development Indicators, World Bank.

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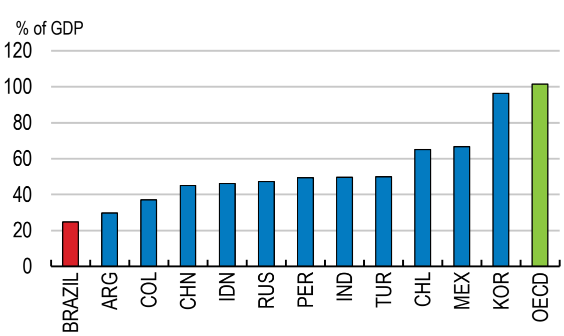
Growth, which was supported by a rising labour force over many years, will slow down due to rapid population aging. Maintaining the growth potential of the economy requires stronger investment, which could also raise productivity and concomitantly, the scope for future wage increases. Public spending has crowded out private investment in the past, and the absence of well-developed private financial markets with longer maturities has hindered the flow of savings into more efficient projects, including infrastructure. Simplifying taxes, reducing administrative burdens and streamlining licensing would raise investment returns. Stronger competition will allow high-performing enterprises to thrive and will further enhance investment opportunities.

Brazil can seize greater benefits from greater global and regional integration

Integration into global trade is weak
Imports and exports, average 2010-2016



Source: OECD Economic Outlook database.

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Integration into global trade is much lower than in other emerging markets as trade barriers shield enterprises from global opportunities and foreign competition. Exports and growth could be stronger if firms could source the best inputs and capital goods from international markets. More exposure to trade will also lead to rising productivity among domestic producers as they improve efficiency and seize new export opportunities. This would create new jobs across the economy, but especially for those with lower skills and incomes, making growth more inclusive. Consumers would also benefit from more competitive prices, with particularly strong effects among low-income households. A stronger integration into the global economy would be an effective way to enhance competition and would help the most productive firms and industries to succeed, although a select few sectors would see their output decline. Well-designed policies that protect workers rather than jobs through a combination of training and income protection, can shield the poor and vulnerable from the burden of adjustment, ensuring inclusive growth.

MAIN FINDINGS	KEY RECOMMENDATIONS
Improving macroeconomic policies and economic governance	
Fiscal outcomes have deteriorated substantially since 2014 reflecting mostly increases in expenditure. A primary surplus of around 2% of GDP is required to stabilise public debt in the medium term.	Implement the planned fiscal adjustment through permanent spending cuts. Gradually raise the retirement age. Index pensions to consumer prices rather than the minimum wage.
Social transfers have raised spending, but only few of them reach the poor.	Delink benefit floors from the minimum wage. Shift more resources towards transfers that reach the poor, including Bolsa Familia.
The Central Bank has conducted monetary policy in an independent way but formalising this independence would strengthen monetary policy effectiveness.	Limit dismissal of the Central Bank governor to severe misconduct to rule out political influence in monetary policy decisions in the future. Safeguard the budget autonomy of the Central Bank.
Targeted industrial support policies have generated substantial rents without effects on investment or productivity.	Scale back sector- and location-specific industrial support policies, including tax benefits. Evaluate existing programmes.
Political consensus building has required costly and inefficient expenditures without systematic audits and reduced the effectiveness of the public sector. This has been a key obstacle to passing reforms.	Limit political appointments, especially in state-owned enterprises. Strengthen performance incentives in public companies. Undertake more systematic audits of all expenditures, including parliamentary budget appropriations.
Public procurement has been subject to large-scale corruption.	Review public procurement laws. Use more centralised purchasing bodies. Strengthen whistle-blower and leniency procedures.
Raising investment	
A challenging business climate including high tax compliance costs, high costs of capital and high administrative burdens curb investment returns while weak competition misallocates resources.	Consolidate consumption taxes at the state and federal levels into one value added tax with a broad base, full refunds for input VAT paid and zero-rating for exports. Reduce barriers to entry due to administrative procedures.
Long-term credit has been dominated by the national development bank BNDES, which creates an uneven playing field and may hamper the development of private investment financing. The recent decision to phase out subsidies in its lending operations will allow a redefinition of the role of BNDES.	Focus BNDES lending activities on niche areas where the private sector finds it difficult to operate, including in the financing of small start-ups and innovation projects. Use BNDES more to arrange syndicated loans for infrastructure and lead the creation of structured financial instruments.
Weak project structuring has been holding back private participation in infrastructure financing. Concessions cannot be used in projects where user fees are not possible.	Provide more training to officials involved in infrastructure structuring. Make wider use of BNDES' technical capacity to assist public entities in project structuring, especially local governments. Make wider use of public-private partnerships but ensure that all present and future liabilities are taken into account in a transparent way.
Fostering the integration into the world economy	
High barriers to international trade reduce benefits from integration into the global economy.	Lower tariffs and scale back local content requirements.
Greater integration into the global economy will reallocate jobs across firms and sectors.	Bolster training and job search assistance programmes for affected workers.
Strengthening green growth	
Deforestation has declined up to 2014 but risen again since then.	Ensure continuous decreases in deforestation, including through stronger enforcement and maintaining the status of areas currently under environmental protection.

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