Chapter 3

Economic stability and trust in institutions in Brazil

This chapter outlines the importance of economic stability and public institutions in fostering public and private investment. It provides an overview of the performance of the overall economy, outlines macroeconomic developments and challenges, and presents an evaluation of public institutions.

The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of the Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law.

Macroeconomic policy environment

The framework conditions for innovation encompass macroeconomic performance, financial and tax systems, openness to international trade and foreign direct investment, infrastructure, labour and education systems. Stable macroeconomic framework and good performance of public governance and institutions are a prerequisite for unleashing and fostering innovation. Innovation is an activity of medium- or long-term horizon that requires a stable environment. Under conditions of economic and political instability and weak institutions, potential innovators will perceive significant risks to longer term undertakings and are unlikely to invest in activity that does not generate rapid returns (OECD, 2010a; OECD, 2010b).

Brazil has been praised for its successful economic transition from the tumultuous decades of the 1980s and 1990s. This success is largely due to the ability of the government to pursue stable and predictable macroeconomic policies based on stable inflation, declining public debt, and a flexible exchange rate. Several key indicators show considerable improvement in macro-economic fundamentals in Brazil over the past two decades, with consumer inflation brought down to one-digit levels, a significant reduction in public debt, an accumulation of international reserves, and a fall in unemployment rate (Table 3.1).

Macroeconomic stability has been essential to building resilience to external shocks, including the global crisis of 2008-09. Specific policy responses to this crisis were appropriate, aimed at increasing liquidity, resolving the credit crunch and providing fiscal stimulus. The economy returned to growth in 2010, but it has lost its earlier momentum. According to the World Economic Forum's 2013-14 *Global Competitiveness Index*, Brazil performed somewhat below the majority of OECD countries and some BRIICS countries (Brazil, Russia, India, Indonesia, China and South Africa). This evaluation is based on the index of macroeconomic environment aggregating key macroeconomic indicators such as the government's budget balance, gross national savings, inflation, government debt, and country credit rating in terms of stability of macroeconomic environment (Figure 3.1).

Table 3.1. Brazil's key indicators of macroeconomic performance

	1995	2001	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014e	2015e	2016e
Real GDP growth, %	..	1.3	3.2	3.9	6.1	5.2	-0.3	7.5	2.7	1.0	2.5	0.3	1.5	2.0
General government financial balance[1]	..	-3.3	-3.6	-3.6	-2.8	-2.0	-3.3	-2.5	-2.6	-2.5	-3.3	-3.9	-3.1	-3.0
Current account balance[1]	-2.4	-4.1	1.6	1.3	0.1	-1.7	-1.4	-2.2	-2.1	-2.4	-3.6	-3.9	-3.6	-3.3
Exchange rate, BRL per USD[2]	0.92	2.35	2.44	2.18	1.95	1.84	2.00	1.76	1.67	1.95	2.16	2.34	2.53	2.53
Inflation, annual %, CPI all items	..	6.8	6.9	4.2	3.6	5.7	4.9	5.0	6.6	5.4	6.2	6.5	5.4	5.1
Unemployment rate, %[3]	..	..	9.9	10.0	9.3	7.9	8.1	6.7	6.0	5.5	5.4	4.9	5.1	5.4

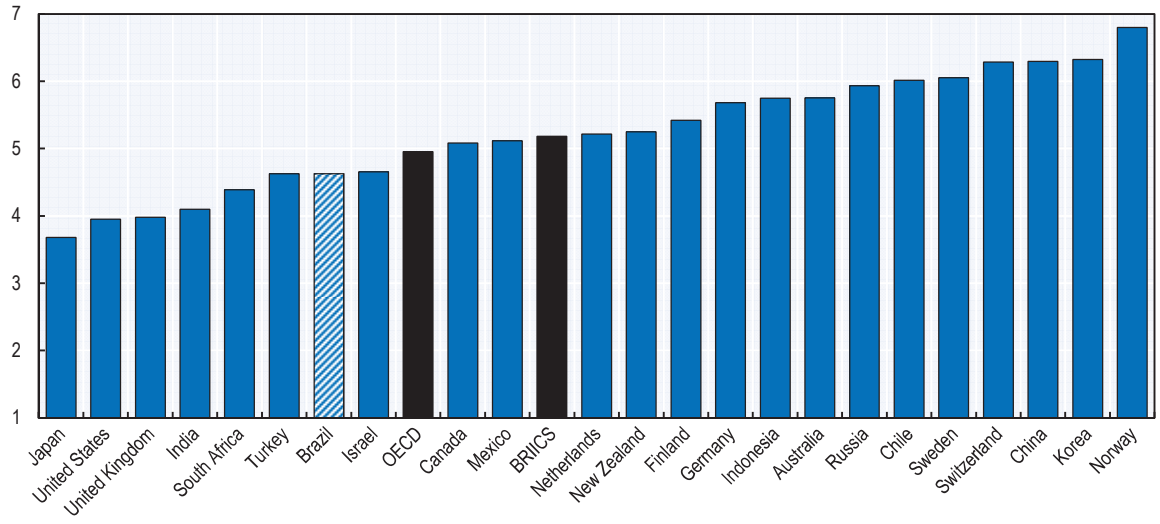
e: *OECD Economic Outlook* estimate.
1. As a percentage of GDP.
2. Period average.
3. End year, as a percentage of total labour force.

Source: OECD Economic Outlook 96 database – November 2014. http://dotstat.oecd.org/.

StatLink http://dx.doi.org/10.1787/888933242860

Figure 3.1. Global Competitiveness Index: macroeconomic environment, 2013-14

Scale 1 to 7 (best)



1. Indices for BRIICS and OECD represent simple averages of member-country indices.
Source: World Economic Forum (2013), *The Global Competitiveness Report 2013-2014*, http://reports.weforum.org/the-global-competitiveness-report-2013-2014/#=.

StatLink http://dx.doi.org/10.1787/888933242403

According to the latest *OECD Economic Outlook* (November 2014), after real GDP declines in the first half of 2014, activity is set to recover gradually in Brazil. Nonetheless, growth will remain modest due to tighter monetary and fiscal policies, weak external demand, low levels of investment and persistent infrastructure bottlenecks. Inflation will only come down slowly, as overdue increases in administered prices are likely to push up inflation temporarily (OECD, 2014).

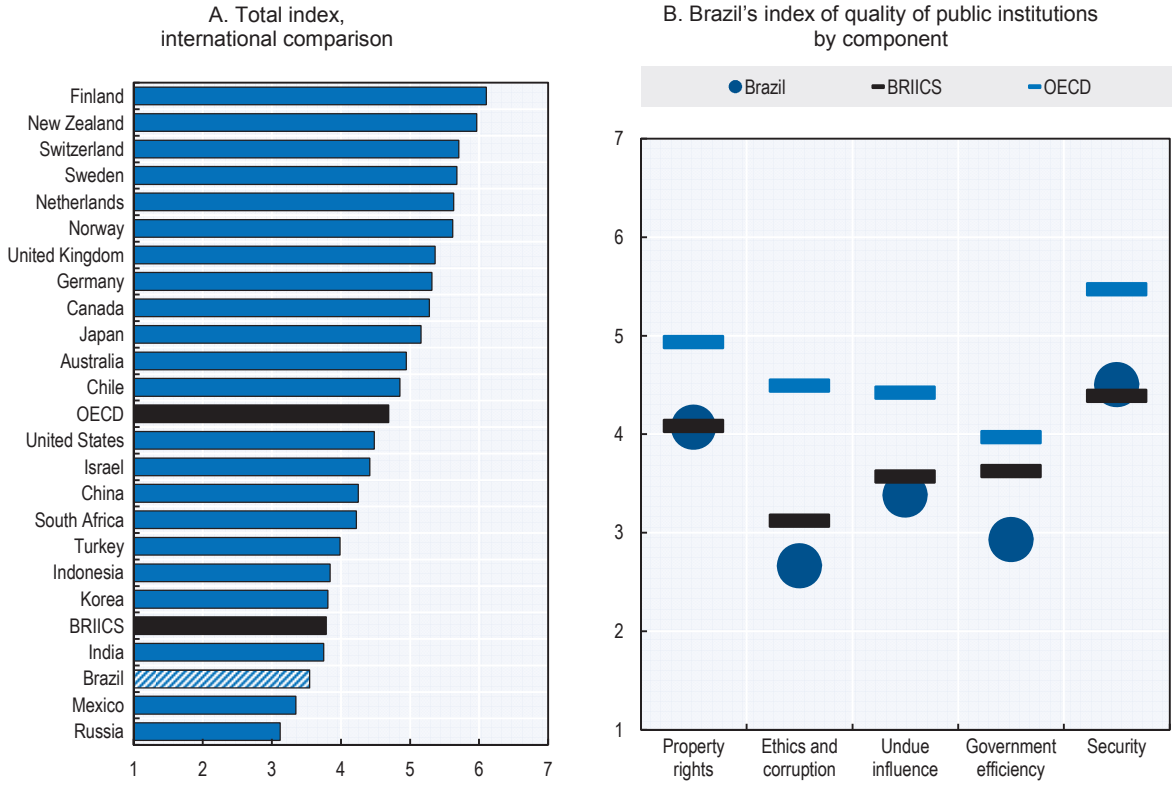
High inflation continues to be a strong factor affecting macroeconomic stability in Brazil. The central bank has appropriately raised its policy rate to reduce inflation. Keeping inflation expectations anchored on the inflation target may require continued tight monetary policy in 2015, despite the weakness of growth. As fiscal performance has deteriorated, more fiscal discipline will be needed in the coming years to ensure a sustainable reduction of gross public debt (OECD, 2014). Another source of uncertainty is the rising household indebtedness, with a debt-service to income ratio of 21%, which exceeds the levels in the United States and many Latin American countries. External risks come from the possible deterioration of global economic conditions. A longer-term challenge is to contain pension expenditures in view of an expected rise in the old-age dependency ratio. Consolidating confidence in the macroeconomic framework in Brazil requires strengthening the existing system for inflation targeting, a tighter fiscal stance with improved clarity of fiscal and quasi-fiscal operations, and greater flexibility to conduct countercyclical fiscal policy (OECD, 2013).

Governance and quality of public institutions

Governance systems and institutions fundamentally affect risk perceptions of potential innovators. When government is accountable, transparent, predictable and non-corrupt institutions work well, and economic agents see their risks reduced and are more willing to exploit the opportunities and invest in innovation. Governance systems play an important role in addressing market failure, influencing the behaviour of firms as well as the efficient functioning of farm input and output markets.

Figure 3.2. Global Competitiveness Index: quality of public institutions, 2013-14

Scale 1 to 7 (best)



Indices for BRIICS and OECD represent simple averages of member-country indices.

Source: World Economic Forum (2013), *The Global Competitiveness Report 2013-2014*, http://reports.weforum.org/the-global-competitiveness-report-2013-2014/#.

StatLink http://dx.doi.org/10.1787/888933242403

OECD Integrity Review for Brazil (OECD, 2012) commends Brazil for continuous reform over the past decade to enhance integrity and prevent corruption within its public administration. These reforms have focussed on increasing transparency and direct citizen oversight over public service delivery; introducing a risk-based approach to internal control within public organisations, and promoting high standards of conduct among federal public officials, in particular to create a culture of integrity and prevent corruption. Acknowledging the progress made, this review, however, stresses the importance of going further in these directions and outlines a broad set of actions required.

The need for further improvement in overall governance is indeed evidenced by the World Bank's governance indicators, which in 2012 positioned Brazil around mid-point in the world ranking on the dimensions of governance, such as voice and accountability, political stability, government effectiveness, regulatory quality, rule of law, and control of corruption. These mid-points, however, are far below the performance levels of OECD countries (WGI, 2013). This is broadly in agreement with the opinion of Brazilian business, as reflected by the WEF's Global Competitiveness Index, which gives relatively modest scores to the quality of the country's public institutions, particularly as this concerns ethics and corruption and government efficiency (Figure 3.2 above).

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