Structural reform priorities for Brazil

Nina Biljanovska (RES) and Damiano Sandri (WHD)

Wilson Center - November 13th, 2018
How to prioritize structural reforms

- Like other EMs, Brazil faces a long list of possible structural reforms

- Doing all reforms at once is unviable
  - Risk of widespread political backlash
  - Better not to overburden public administration

- So how to identify reform priorities?
  - Common answer is to look at economic impact
  - But this approach is somewhat naïve since it fails to consider political obstacles
To identify reform priorities, we suggest a two-step approach:

1. Choose reforms with **strongest economic impact**
2. and **highest public support**

Choice of which reform to prioritize can also be influenced by:

- legislative considerations
- fiscal implications

In this presentation, we apply this methodology to Brazil.
I. Economic impact of reforms
Assessing economic impact of reforms

- We follow empirical literature on the effects of structural reforms
  - Ostry et al. (2009), Bouis and Duval (2011), Prati et al. (2013), IMF (2015)

1. **Estimate impact** of reforms on TFP growth using panel regressions

2. **Measure structural reform gaps** in Brazil relative to advanced economies

3. Multiply estimated impacts by reform gaps to obtain overall effects in Brazil
Economic impact of structural reforms

Impact of reforms on one-year-ahead TFP growth in Brazil, percent
II. Public support for reforms
How to assess public support for reforms?

- To assess public support, we use survey data from Latin Barometer

- One question asks about people’s support for free-market economy
  - Across Latam, support for reforms increases with economic growth
  - Be proactive, don’t delay reforms until crisis strikes

- Another question asks about the key issues for economic development

- Some answers can be easily matched to structural reforms
  - “Integration to the world” as support for trade reforms
  - “Rule of law” and “Quality of public institutions” as support for legal reforms
Matching with structural reforms

- In other cases, the matching with structural reform is less straightforward
  - “Productivity” and “Innovation” as support for banking and product-market reforms
  - “Equity of opportunity” as support for labor market reforms

- Two exercises to validate our matching procedure

1. Call for “innovation/productivity” stronger in countries lagging in banking/product reforms
2. Call for “equity of opportunity” stronger by winners from labor reforms, e.g. unemployed
Public support for reforms in Brazil

- Product market/Banking sector: 31%
- Legal system: 26%
- Openness: 23%
- Labor market: 15%
III. Identifying reform priorities
The impact-support frontier

- Using our two-step approach, we can draw impact-support frontier

![Diagram: Economic impact and public support for reforms in Brazil](image)

- Banking sector reforms have **strongest economic impact** and **highest public support**
The impact-support frontier

- Using our two-step approach, we can draw impact-support frontier

Banking sector reforms have strongest economic impact and highest public support. They are also simple to legislate without congressional approval. By reducing credit subsidies, they also generate fiscal gains.
Conclusion

- To select reform priorities, we propose a two-step approach considering:
  1. *economic impact* estimated with conventional empirical techniques
  2. *public support* based on the analysis of survey data
     - Priorities can also be influenced by legislative considerations and fiscal impacts

- To maximize public support, *do reforms when economy is growing*

- *Banking reforms* can generate highest economic gains at the lowest political cost
  - They are also simple to legislate and deliver fiscal savings