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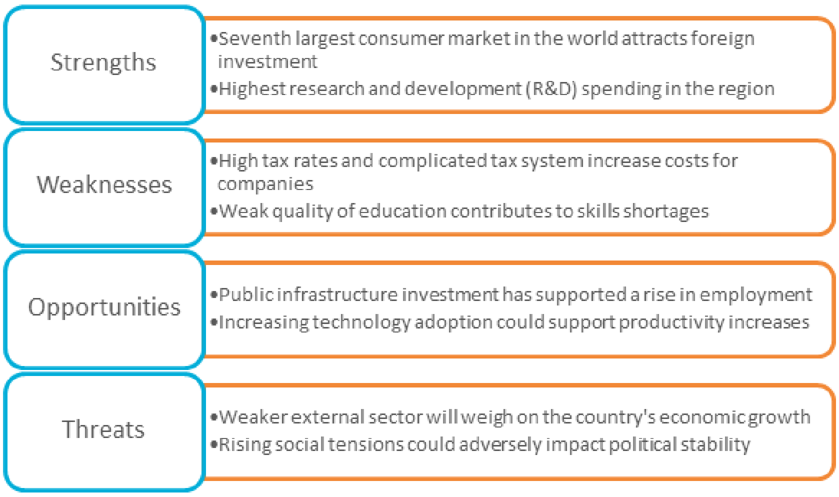
Business Environment: Brazil

Country Briefing | 11 Mar 2015

Brazil's business climate benefits from generally open policies towards foreign direct investment (FDI), government support to infrastructure and innovation activities, and a developing information and communications technology (ICT) sector. However, several challenges remain in the form of excessive bureaucratic procedures, a cumbersome tax system, and weak quality of education, while Brazil's economic deceleration is also feeding rising social tensions and protectionism of local industries.

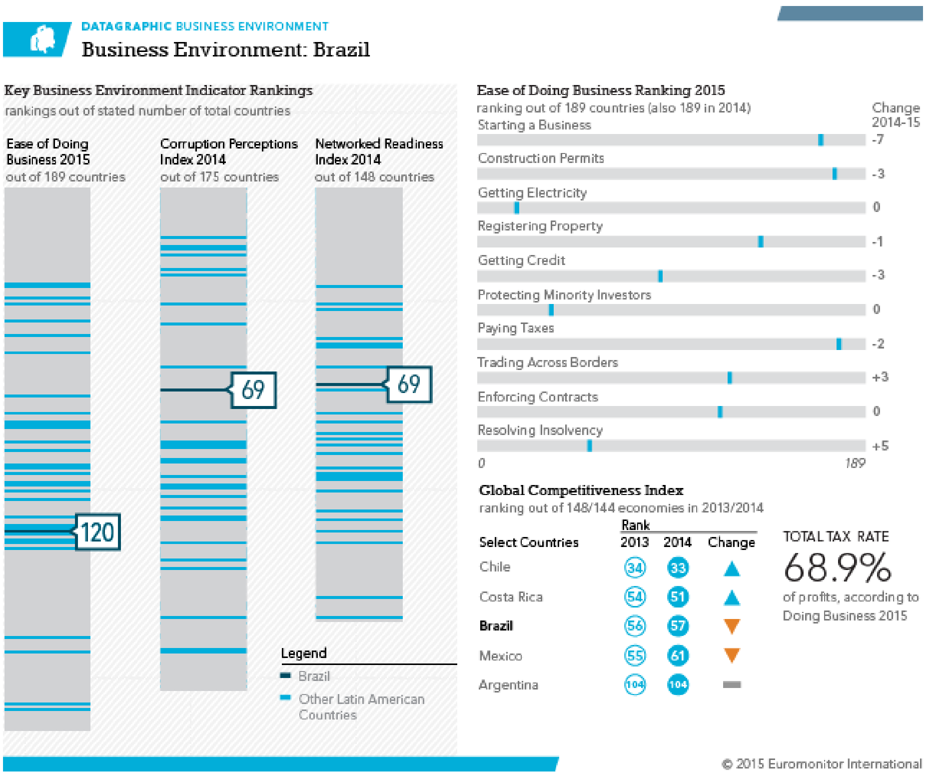
Chart 1 SWOT Analysis: Brazil



Source: Euromonitor International

OPERATING ENVIRONMENT

Chart 2 Overview of the Business Environment in Brazil: 2014



Source: Euromonitor International from Doing Business, World Bank; Global Competitiveness Index, World Economic Forum; Networked Readiness Index, World Economic Forum; Corruption Perceptions Index, Transparency International.

Notes: Regulations in Doing Business 2015 are measured from June 2013 until June 2014. The data for all sets of indicators in Doing Business 2015 are from June 2013 until June 2014 (except for paying taxes data which refers to January–December 2013). Doing Business presents quantitative indicators on business regulations and the protection of property rights that can be compared across economies. A high ranking means the regulatory environment is conducive to the operation of business.The Global Competitiveness Index measures the microeconomic and macroeconomic foundations of national competitiveness, taking into account 12 subjects - Institutions, Infrastructure, Macroeconomic stability, Health and primary education, Higher education and training, Goods market efficiency, Labour market efficiency, Financial market sophistication, Technological readiness, Market size, Business sophistication and Innovation.The Networked Readiness Index (NRI) measures the propensity for countries

High levels of red tape continue to prevail in business regulations

Ease of Doing Business

- In the World Bank's Ease of Doing Business (Doing Business) 2015 report, Brazil ranked 120th out of 189 economies, gaining three places from 123rd out of 189 countries in the 2014 report. At a regional level, Brazil ranked 24th out of 32 countries in the Latin American & Caribbean region, behind Colombia (34th) and Mexico (39th) but ahead of Argentina (124th).
- In Doing Business 2015, Brazil recorded its best performance in the category 'Getting electricity', where it ranked 19th at a global level. This was due to the relatively low cost (31.6% of income per capita) and short time (58.0 days) necessary to get a permanent electricity connection in Brazil, compared to the regional averages of 445% of income per capita and 67.4 days, respectively.
- Brazil ranked 100th or lower in six out of 10 categories of Doing Business 2015, reflecting excessive levels of red tape that continue to prevail in the country's business regulations. Apart from 'Paying taxes', Brazil's worst performing category in Doing Business 2015 was 'Dealing with construction permits' (174th at a global level), owing to the high number of procedures (19.0) and time (400 days) required to build, connect and register a warehouse in the country, compared to the averages of 13.3 procedures and 178 days for the Latin American & Caribbean region.
- The greatest variation in Brazil's Doing Business 2015 rankings, compared to the previous year, was observed in the 'Starting a business' category, where Brazil lost seven positions to rank 167th at a global level in Doing Business 2015. This reflected the lack of reforms to business regulations by the Brazilian government, with no reforms of note to any category of doing business recorded during 2014. As a result, Brazil was overtaken by economies like Benin, Timor-Leste and Togo, which made significant reforms to facilitate business start-up during 2014.

Government Finances, Inflation and Credit Availability

- After contracting by 0.3% in 2009 due to the impact of the 2008-2009 global economic crisis, Brazil's real GDP grew on average by 1.6% per year over the period 2010-2013, on the back of high levels of government spending and increasing exports. Nevertheless, in 2014 the Brazilian economy registered flat growth, as decelerating economic expansion in China and declining global prices of commodities negatively impacted the Brazilian external sector.
- High levels of government expenditure have led to persistent general government budget deficits during the period 2009-2014, which reached 3.9% of total GDP in 2014 (up from 3.3% of total GDP in 2009). High government spending has also fuelled inflationary pressures in the Brazilian economy, with annual inflation reaching 6.3% in 2014, compared to 4.9% in 2009. In 2014, the country's public debt levels as a percentage of total GDP stood at 65.8%.
- After peaking at 4.2% in 2009 due to the impact of the 2008-2009 global economic crisis, the proportion of bank nonperforming loans out of total gross loans has eased to 2.9% in 2014, on the back of Brazil's economic expansion during this period.
- Business confidence levels have followed a downward trend since the beginning of 2013, and reached their lowest level in over eight years in Q4 2014, as a consequence of the country's slowing economic growth, easing domestic demand, and weakening exports.

Global Competitiveness Index

- In the Global Competitiveness Index (GCI) 2014 published by the World Economic Forum, Brazil held the 57th position out of 144 countries, compared to 56th out of 148 economies in the previous year. The country's ranking in the GCI 2014 was behind Chile (33rd) but ahead of Bolivia (105th).
- Brazil recorded its highest score in the GCI 2014 rankings in the sub-category of 'Market size' (where it ranked ninth at a global level), on the back of its large consumer market (worth US$1.3 trillion in 2014, the seventh largest in the world). On the other hand, Brazil's lowest score corresponded to the 'Goods

market efficiency' sub-category (123rd at a global level), reflecting the impact of elevated taxes, high levels of red tape and trade barriers on competition, productivity and overall business activity in the country.

Political Stability and Regulatory Quality

- Brazil continues to show high levels of poverty and income inequality, despite rising levels of social spending by the Brazilian government since the early 2000s. These factors, combined with the deceleration of the economy observed since 2012, have contributed to the resurfacing of social tensions in the country.
- In 2013, large-scale protests in several cities of Brazil occurred owing to popular discontent with deficient public services, elevated inflation, and high levels of corruption. Protests continued into 2014 especially during the celebration of the FIFA World Cup held in Brazil in June and July 2014. As a result, Brazil's position in the World Bank's 'Political stability and absence of violence index', fell to 127th out of 203 countries in 2013 (latest data available), from 104th out of 203 economies in the previous year.
- Brazil's complex regulatory framework is a challenge for companies operating in the country, which suffer from long bureaucratic delays, efficiency losses, and additional costs owing to red tape. In the 'Regulatory quality index' published by the World Bank, Brazil ranked 92nd out of 202 economies in 2013 (latest data available). Companies doing business in Brazil also need to learn to navigate through the burdensome regulations and interact with the Brazilian public sector and society in general, something commonly referred as 'jeitinho'.

Corruption

- Corruption levels in the country are perceived as problematic, with several scandals involving top government officials as well as managers of state-owned oil company Petrobras coming out to light during the first half of the 2010s. According to Transparency International's Corruption Perceptions Index 2014, Brazil ranked joint 69th (together with six other countries) out of 175 economies, comparing unfavourably to Costa Rica (47th) but ahead of Venezuela (161st).

TRADE ENVIRONMENT, REGULATIONS AND INFRASTRUCTURE

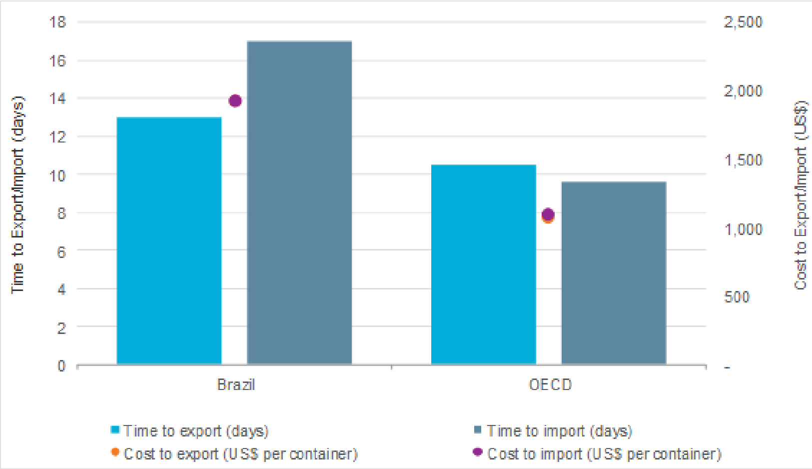
Foreign investment inflows remain below potential

Government Attitude to FDI

- Brazil has generally open policies towards foreign direct investment (FDI) and the government tries to encourage foreign participation in the economy. Nevertheless, the there are still some sectors that impose limits to foreign investment, including insurance, aviation, media and highway freight. The plan 'Brasil Maior', introduced by the Brazilian government in 2011, increased protectionism to domestic industries by establishing rules for public procurement that favour products with local content.
- On the other hand, Brazil offers various incentives to investment that apply to both domestic and foreign capital. Subsidised financing is available from the country's state-owned development bank (BNDES), while tax rebates for exporters grant a 3.0% subsidy on the value of exports (provided some thresholds on national content of exported products are met). Tax benefits are also extended to investment in less developed areas of the country like the Amazon and Northeast regions.
- Brazil has been a member of the Mercosur trade bloc (which also includes partners Argentina, Uruguay, Paraguay and Venezuela) since 1991. In addition, Brazil has been a member of the World Trade Organization since 1995.

Chart 3 Trading Across Borders Time and Cost to Import/Export: 2014

US$/days



Source: World Bank Group's Ease of Doing Business report

Trends in FDI Flows

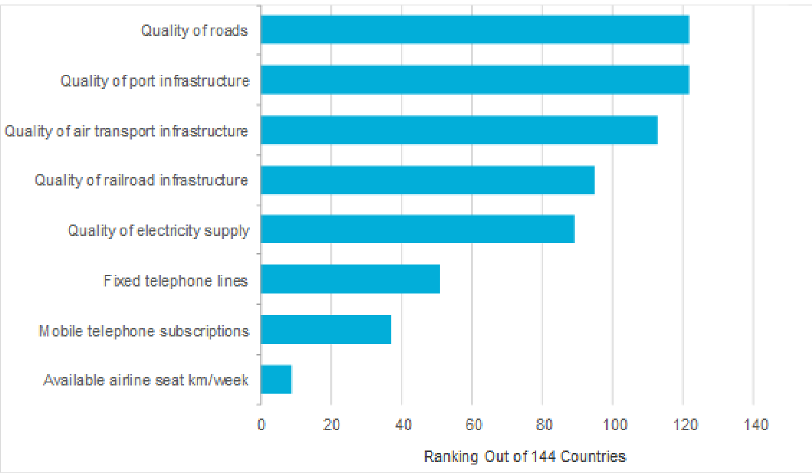
- Factors like high levels of red tape, cumbersome taxes and weak infrastructure continue to weigh on foreign investment inflows into the country and keep them below potential. As a consequence, FDI intensity into Brazil has averaged 2.5% of total GDP during the period 2009-2013 (2.9% of total GDP in 2013 alone), below the Latin American average of 4.1% of total GDP over the same period.
- After declining by 40.1% year-on-year (y-o-y) in real terms to reach BRL51.9 billion (US$25.9 billion) in 2009 owing to the impact of the global economic crisis, FDI inflows into Brazil rose to a historical high of BRL138 billion (US$64.0 billion) in 2013 (latest data available), as the country's economic recovery attracted inflows into Brazil's services, manufacturing and oil sectors.
- On the other hand, FDI outflows (or investment abroad by Brazilian companies) averaged -0.4% of total GDP over the period 2009-2013 (latest data available). The negative value in FDI outflows indicates that Brazilian companies with investments abroad actually repatriated capital to Brazil during that period, as a result of more challenging economic conditions in the domestic market.

Infrastructure

- Brazil has a generally weak infrastructure network that is not conducive to business activity. For example, the proportion of paved roads in Brazil reached only 14.0% in 2014 (compared to the OECD and Latin American averages of 70.0% and 22.0% respectively), contributing to logistics bottlenecks, and increasing transportation costs. In the World Economic Forum's Global Competitiveness Report 2014, Brazil ranked 76th out of 144 countries in the category 'Infrastructure', while in the sub-category 'Quality of overall infrastructure', the country ranked 120th at a global level, reflecting the generally poor state of Brazilian infrastructure;
- A large part of Brazil's infrastructure investment during the first half of the 2010s has focused on the sports events FIFA World Cup (held in 2014) and the Olympic Games (to take place in Rio de Janeiro in 2016). After the completion of the first phase of the public infrastructure plan "Programa de Aceleração do Crescimento" (PAC) in 2010, the Brazilian government launched the second phase of the programme "PAC 2" in 2011, which has driven investments worth over BRL1.0 trillion (US$417 billion) during 2011-2014. In addition, the government started the plan "Programa de Investimento em Logística" (PIL) in 2013, which projects around BRL250 billion (US$104 billion) in private investments focusing on roads, railroads, ports and airports. Nevertheless, budgetary pressures and a slowing economy may affect the execution of these investments over the medium term.

Chart 4 Infrastructure Ranking in Global Competitiveness Index: 2014

Ranking out of 144 countries



Source: Global Competitiveness Index, World Economic Forum

TAX ENVIRONMENT

Complex tax system is a major weakness

Ease of Paying Taxes

- Brazil ranked 177th out of 189 economies in the 'Paying taxes' category of Doing Business 2015, reflecting the country's highly complicated tax system that is a major drag to the country's competitiveness. Brazil's Doing Business 2015 ranking for 'Paying taxes' was the third to last amongst Latin American & Caribbean economies, ahead only of Venezuela (188th) and Bolivia (189th);

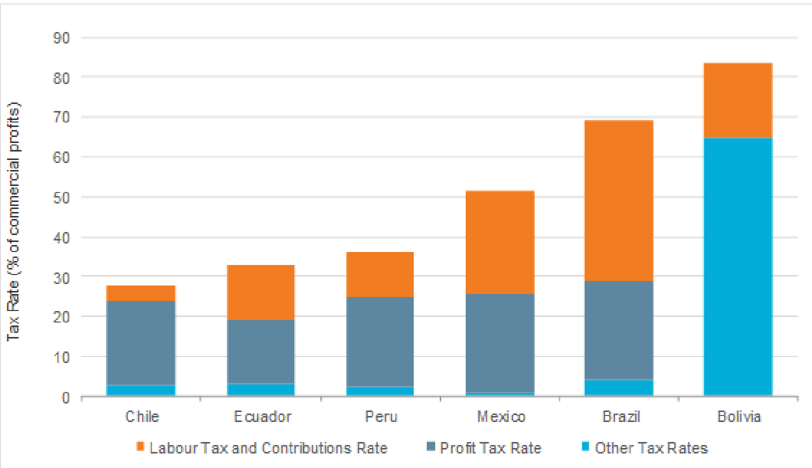
- It takes on average 2,600 hours per year for a company to prepare, file, pay or withhold its taxes and contributions in Brazil, according to Doing Business 2015. This figure is the highest in the world, reflecting Brazil's numerous taxes and contributions, multiple and complex tax schemes and inefficient tax collection procedures that increase the time and resources required by companies to fulfil their tax obligations;

- According to Doing Business 2015, Brazil's total tax rate as a percentage of total profits reached 68.9% of total profits, one of the highest in the world;

- The country has a large informal sector which represented 42.0% of the total labour force in 2013 (latest data available), according to data from the Instituto Brasileiro de Geografia e Estatística (IBGE, Brazil's national statistics office). The vast informal sector contributes to tax evasion levels, which according to estimates from the Union of Procurators of the National Treasury of Brazil, reached up to BRL415 billion (US$189 billion) in 2013 (latest data available), equivalent to 8.6% of total GDP.

Chart 5 Breakdown of Total Tax Rate in Selected Countries: 2013

% of commercial profits



Source: World Bank's Ease of Doing Business Reports

Tax rates

- The standard corporate income tax rate stands at 15.0% in 2015, although a 10.0% surcharge – applying to companies with an annual taxable income over BRL240,000 (US$100,000) – and a 9.0% social contribution (CSLL) take the total effective tax rate to 34.0% for the majority of companies.

Alternative corporate income tax schemes which run simultaneously - including “actual income”, “presumed income” and small enterprises schemes – increase the complexity of the system.

- The country features several VAT-like taxes including the IPI (applied at federal level, at an average of 20.0%) and the ICMS (at state level, at a rate of up to 25.0%). In addition, companies operating in the country are subject to numerous additional taxes and contributions including PIS and COFINS (federal taxes on gross revenue, at rates of up to 1.7% and 7.6% respectively); a tax on financial transactions (IOF); a property tax; and a vehicle tax.

INNOVATION AND TECHNOLOGY

Research and development (R&D) spending is the highest in the region

Uptake of Technology

- Brazil’s information and communications technology (ICT) sector is liberalised and it has recorded sustained growth over 2009-2014, backed by increasing levels of per capita disposable income, and by the impact of government connectivity programmes during this period;

- As a consequence, Brazil’s mobile penetration rate jumped from 78.5% of households in 2009 to 96.1% of households in 2014, the second highest in Latin America after Chile (97.0% of households in 2014);

- Likewise, the percentage of the Brazilian population using the Internet increased from 39.2% in 2009 to 54.6% in 2014, higher than the regional average of 45.5% in 2014. Business usage of the Internet is also widespread, reaching 99.0% of the total number of businesses in 2014 (up from 92.7% in 2009).

Networked Readiness Index

- In the Networked Readiness Index (NRI) 2014 published by the World Economic Forum, Brazil ranked 69th out of 148 economies, dropping nine positions from 60th out of 144 countries in the 2013 NRI rankings. Despite Brazil’s increasing penetration rates of telecom services and improvements to its ICT infrastructure, its rankings in the NRI 2014 declined as other economies like Indonesia, Armenia and Thailand have been faster to embrace the digital transformation. In the NRI 2014, Brazil ranked behind Costa Rica (53rd) but ahead of Argentina (100th).

Research and Development

- Between 2009 and 2014, total expenditure on research and development (R&D) in Brazil rose by 22.9% in real terms to reach BRL62.2 billion (US$26.4 billion) by the end of that period. As a percentage of total GDP, Brazil’s total R&D spending stood at 1.2% in 2014, the highest amongst Latin American countries. This has been the result of increased spending on innovation by the Brazilian government as well as incentives and requirements on R&D spending to the private sector;

- Amongst the incentives provided for innovation spending to the private sector are an exclusion from the corporate income tax base of up to 100% of R&D project expenses, and the offering of direct assistance and tax relief for qualified R&D and information technology projects. In addition, the development of the Brazilian ICT sector has been backed by government connectivity programmes like the ‘Plano Nacional de Banda Larga’ (which ran from 2010 to 2014, with the objective of providing broadband at affordable prices to all Brazilian municipalities) and ‘Cidades Digitais’ (seeking to offer comprehensive digital services to small municipalities in the country).

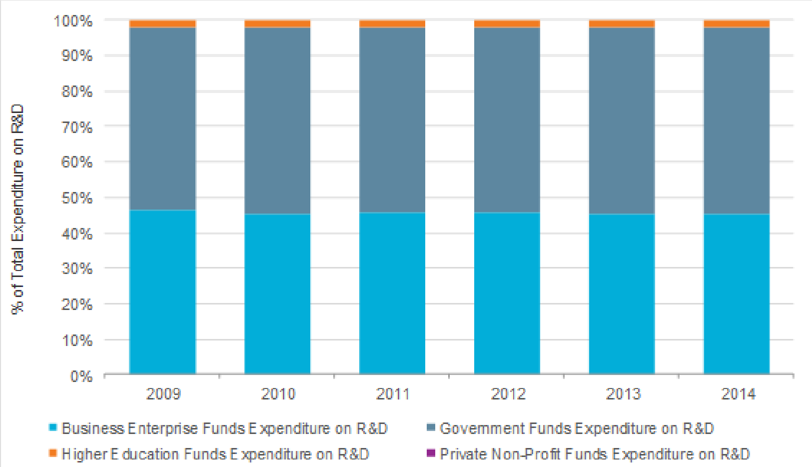
Patent Numbers, Protection and Targets

- Reflecting increasing innovation spending, Brazil received 198 patents by the United States Patent and Trademark Office (USPTO) and 84.7 patents by the European Patent Office (EPO) for a total of 283 patents in 2014, up from a total of 113 patents in 2009. This compares favourably to countries like Mexico and Argentina, which were granted 127 and 55.9 patents respectively by both the USPTO and the EPO in 2014;

- Brazil has been a member of the World Intellectual Property Organization (WIPO) since 1975. The Instituto Nacional da Propriedade Industrial (INPI), manages, grants and guarantees intellectual property rights in the country. Brazil’s Industrial Property Law complies with international standards related to patent and trademark protection, although the law allows the grant of a compulsory licence if a patent owner has not proceeded to locally manufacture the patented product within a three-year period of the patent issuance.

Chart 6 Total Expenditure on R&D by Category: 2009-2014

% of total expenditure on R&D



Source: Euromonitor International from UNESCO/ Eurostat

Note: R&D refers to research and development.

LABOUR MARKET AND POPULATION SKILL SET

Deficient quality of education weighs on productivity levels

Government Expenditure on Education/Education Standards

- According to data from the Brazilian government, public spending on education as a percentage of total GDP stood at 5.3% in 2013 (latest data available), compared to 5.7% in 2009. In 2014, the Brazilian government approved a new 'National Education Plan' which requires government spending on education as a percentage of total GDP to be raised to 7.0% by 2015 and to 10.0% by 2020. However, budgetary constraints will make it challenging for the government to meet these targets;

- As a result of government literacy programmes, Brazil's adult literacy rates (as a % population aged 15+) have risen over the long term, from 82.0% in 1990 to 91.5% in 2014;

- However, the quality of the Brazilian educational system is perceived as weak, as reflected by the country's ranking in the 'Quality of the education system' sub-category of the Global Competitiveness Report 2014, where Brazil held the 126th position out of 144 economies.

Higher Education and Skills Shortages

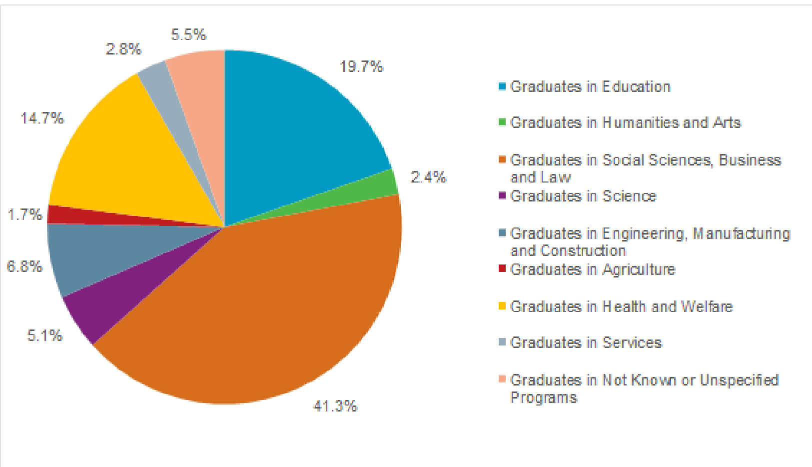
- Only 9.7% of Brazilian population aged 15+ had a higher education degree in 2014; this proportion is the second lowest in the region, only ahead of Guatemala (4.7%);

- In 2014, Social Sciences, Business and Law accounted for the largest proportion of graduates in the country, at 41.3%. This was followed by Education, and Health and Welfare, which represented 19.7% and 14.7% of total Brazilian graduates in the same year;

- On the other hand, Agriculture, and Humanities and Arts accounted for the least number of graduates in Brazil, at just 1.7% and 2.4% of the total respectively in 2014.

Chart 7 Graduates by Discipline: 2014

% of total

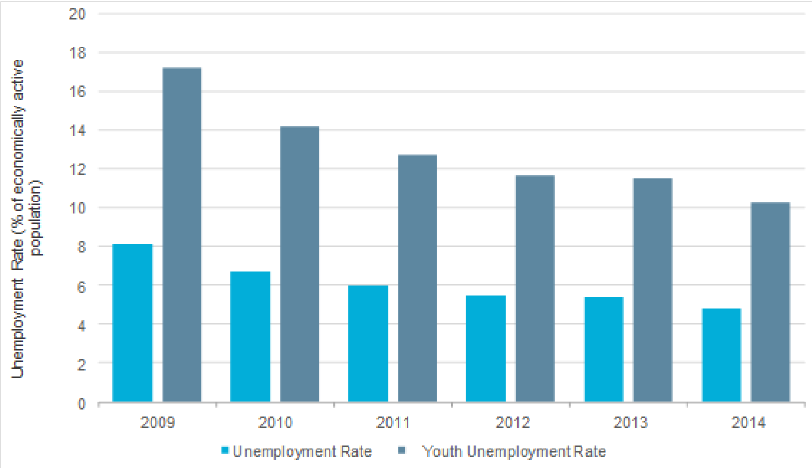


Source: Euromonitor International from OECD/UNESCO

- Brazil’s economic expansion since the mid 2000s has helped ease the problem of brain drain in the country. Nevertheless, the low quality of Brazil’s educational system continues to generate skills shortages that are most evident for positions like production operators, technicians and engineers.

Chart 8 Unemployment Rate, Youth Unemployment Rate: 2009-2014

% of economically active population/% of economically active population aged 15-24



Source: Euromonitor International from UNESCO/national statistics/International Labour Organisation (ILO)/OECD/Trade Sources

Labour Market Landscape

- After peaking at 8.1% in 2009 owing to the effects of the global economic crisis of 2008-2009, Brazil’s unemployment rate as a percentage of economically active population declined gradually to 4.8% in 2014 on the back of the country’s economic recovery. Nevertheless, youth unemployment rates over this period have remained over twice as high as overall unemployment rates, reaching 10.3% of economically active population aged 15-24 in 2014, reflecting the country’s deficient quality of education as well as employers’ preference for experienced personnel;

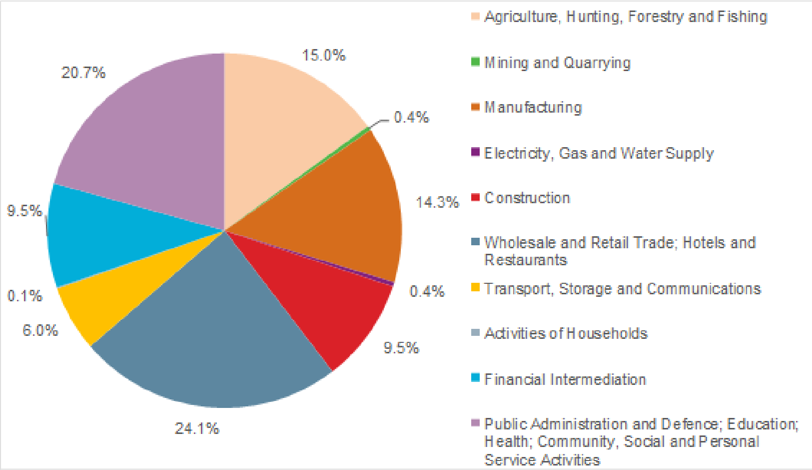
- Over the period 2009-2014, Construction was the industry recording the highest employment gains, with its share of total employment increasing from 8.0% to 9.5% during that period, backed by public infrastructure spending as part of the PAC and PIL programmes;

- On the other hand, the Agriculture, Hunting, Forestry and Fishing sector registered the largest decline in employment over 2009-2014, with its proportion of total employment falling from 18.5% in 2009 to 15.0% in 2014, reflecting the decreasing importance of this sector in the Brazilian economy over the long term;

- In 2014, Brazil’s female employment rate stood at 65.0% of female population in working age (15-64), up from 59.2% in 2009. This is significantly lower than the male employment rate which reached 82.3% of male population in working age in 2014, up from 81.9% in 2009. The difference between female and male employment rates is the result of cultural characteristics of the Brazilian society and lack of labour opportunities that traditionally kept Brazilian women out of the labour force. However, the gap is expected to narrow over the long term owing to factors like increasing educational attainment of Brazilian women; greater labour opportunities for females; and cultural shifts in the Brazilian society (where double-income households are gaining predominance).

Chart 9 Employment by Industry: 2014

% of total



Source: Euromonitor International from International Labour Organisation (ILO)/national statistics

Notes: (1) 'Wholesale and Retail Trade' includes Repair of Motor Vehicles, Personal and Household Goods; (2) 'Financial Intermediation' includes Real Estate, Renting and Business Activities; (3) 'Undefined sectors' refers to activities not adequately defined elsewhere in the other categories.

Wages and Productivity

- The country's labour market is highly rigid, increasing difficulties for companies to adjust their labour force to the economic cycle. In the Global Competitiveness Report 2014, Brazil ranked 135th out of 144 economies in the sub-category 'Hiring and firing practices', while in the 'Flexibility of wage determination' sub-category the country held the 125th place at a global level, reflecting Brazil's cumbersome and inflexible labour regulations;

- In 2014, the country's average wage per hour for manufacturing stood at BRL8.1 (US$3.4), while the average wage per hour for all economic activities was BRL9.1 (US$3.9). These wage levels rank amongst the highest in the region, adversely impacting the competitiveness of Brazil's manufacturing and services sectors;

- Brazil's minimum wage per month stood at BRL678 (US$288) in 2014, after having increased by 9.4% in real terms over the period 2009-2014, increasing costs for companies operating in the country;

- Productivity levels in Brazil (measured as GDP per person employed) reached US$17,818 in 2014. This is lower than the Latin American average of US$19,973, and is significantly below economies like Venezuela (US$35,756) and Chile (US$30,193), reflecting Brazil's elevated tax rates, deficient quality of education, and rigid labour markets.

Definitions:

Political Stability and Absence of Violence: measures perceptions of the likelihood that the government will be destabilised or overthrown by unconstitutional or violent means

Regulatory Quality Index: measures perceptions of the ability of the government to formulate and implement sound policies that permit and promote private sector development

Networked Readiness Index: measures the propensity for countries to exploit the opportunities offered by information and communications technology