A conflict between social and economic goals



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Social Security reform is urgently needed. The questions are how to reconcile views and set priorities, and how to maintain economic sustainability while recognizing the social implications. Currently there are three different social security systems: the General System of Social Security (RGPS) for private sector employees, the public employees' pension plan, and the military pension plan. Reform is also necessary to improve Brazil's international image: "If the market believes that our fiscal stance is not sustainable because of social security commitments, Brazil can fall out of favor," says Vagner Laerte Ardeo, deputy director of the Brazilian Institute of Economics (IBRE) of the Getulio Vargas Foundation (FGV).

The Organization for Economic Cooperation and Development (OECD) says that reform of Brazil's pension system would be beneficial to savings and investment because it costs close to 9% of GDP and the cost is expected to rise as the population ages. The OECD recommends that Brazil set a minimum age for retirement, which is being considered along with new rules for retirement by public employees, the end of the social security factor, and new pension eligibility rules.

Adjustments

The federal government is working for adoption of the Supplementary Pension Fund for the Federal Public Employees (Funpresp) and is not raising pensions above the minimum wage, though it promises to review the budget during the year to assess the possibility of a real adjustment of benefits. But everything depends on what happens with the international crisis. Ardeo explains that "Europe is making adjustments to its social security arrangements. It is essential that we make adjustments now so that we do not find ourselves in a difficult situation in the future."

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the labor market help to pay for the benefits of those who are retiring. The contributions they make are not for their own future pensions," says Gabriel Leal de Barros, an IBRE economist, who reminds us that Brazil's demographics today are quite different from three decades ago.

Because the policy of raising the minimum wage, which began during the Cardoso administration, was intensified under Lula and has been maintained by Rousseff, there has been a growing gap between pensioners who receive a minimum-wage pension and pensioners who receive more than the minimum wage. In most years adjustments to the minimum wage have exceeded adjustments of social security benefits. This has led workers and pensioners to pressure Congress for similar adjustments. However, matching the adjustments would be a step toward breaking up social security.

Ardeo explains that "The biggest difficulty we face in social security as a whole is the link of pensions to the minimum wage, because this affects not only the short term but also the future. We can discuss how you manage the interests of the current generation over future generations, but I think it is also in pensioners' interests that social security be sustainable." He adds that the ideal would be a minimum benefit indexed to inflation.

Today, Brazil has 24 million RGPS pensioners, of whom 18 million have a minimum-wage pension; its benefits increase, because each year it is adjusted for inflation plus real GDP growth. "The policy of increasing the minimum wage serves 40 million active workers and most pensioners. The 30% of pensioners who earn above the minimum wage should have another adjustment rule," says Artur Henrique, president of the Workers Central Union (CUT). For him the proposal to adjust pension benefits for those earning more than the minimum by inflation plus 80% of GDP, or even the creation of an index by age, should be examined closely.

Mismatches

"When we were working and contributed to Social Security according to our salaries, our expectation was that when we retire, we would receive benefits accordingly. But when we retire, we lose because of the social security factor[1] and we have also lost over the years because the government gives a 14% adjustment to the minimum wage and 7% for pension benefits," complains Nelson de Miranda Osório, chief financial officer of the Confederation of Retirees and Pensioners of Brazil (Cobap).

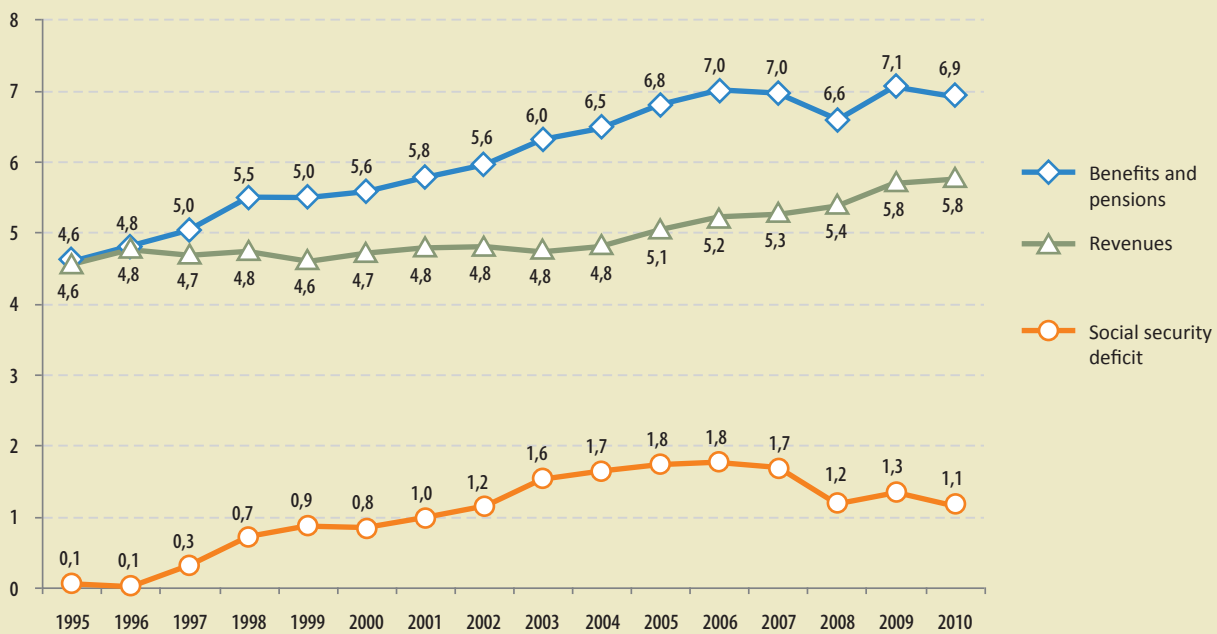
However, "the issue is complicated," says Gilberto Guerzoni, legal adviser to the Senate. He says that since the Real Plan in 1994, social security benefits have not lost any purchasing power because yearly adjustments are based on the National Consumer Price Index (INPC). He says, "If today [a retiree] goes to the supermarket to buy with

current income, that person will be able to buy the same things she used to buy in 1994. Her neighbor, who continues to earn the equivalent of a minimum wage, will buy twice as many things because he has had more significant increases, and it is this comparison that gives an impression of loss." Leal de Barros agrees: "Pensions have been adjusted by inflation and the purchasing power of retirees' pensions is not being eroded."

How to transfer the economy's productivity gains to pensioners who earned above the minimum wages is a political decision, Guerzoni says. "This is a decision that involves prioritizing. What is most important for the country?" asks Senator Paulo Paim (PT-RS). He says the government is reluctant to adjust more pensions above the minimum wage because of concerns about creating imbalances in social security accounts. However, he argues that the amounts the government gives up through tax exemptions plus withdrawals from other budget accounts are higher than the expenses resulting from adjustment of pensions. He explains that "The government in 2010 withdrew R$45 billion from the social security budget to use elsewhere. In the current budget bill, waivers for contributions to social security totaled R$23.3 billion. Thus

The structural social security deficit has grown as a result of generous benefits and extending benefits to groups that contribute little.

Percent of GDP



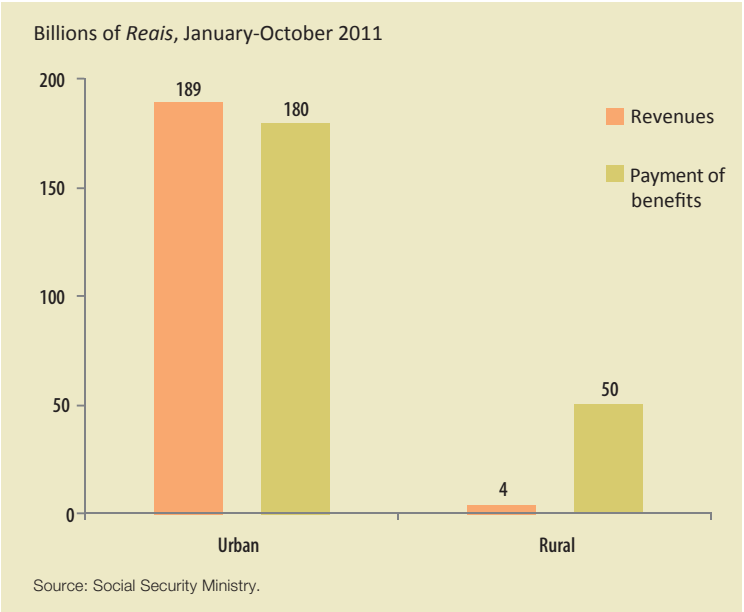
Source: Statistical Yearbook of Social Security.

there is almost R$70 billion that was diverted from the social security budget."

Denize Campello, a lawyer specializing in public law and the public budget, argues that "Adjusting pensions by past inflation plus 80% of GDP growth would increase the costs of social security by R$10 billion. This could be done without any impact on social security accounts." Leal de Barros disagrees: "When the government gives tax incentives to an activity or sector, it is a public policy for development. Regardless of the tax incentive, the government, in net terms, is paying the same. A tax incentive is discretionary; at any time it can be removed. The pension issue must be resolved in a coherent and sustainable way."

Reallocating resources within the budget has no substantial effects on social security accounts, in the opinion of Eduardo Pereira, coordinator of statistics of the Ministry of Social Security: "The way the government operates the social security budget, it needs to replace any missing money." Paim responds, "If it does not matter, let's approve the law that forbids social security resources being used for other purposes."

Geographic imbalance: The social security deficit result in part from pensions paid to rural workers who contribute virtually nothing to social security.



Source: Social Security Ministry.

Premature

Paim also argues for the end of the social security factor, created in 1999 after the government was not able to agree on a minimum age for retirement. "I support a universal pension, equal for all, without privileges to anyone," he says. "Since the executive, legislative, and judicial branches, which have the highest salaries, have no social security factor, we should end the factor once and for all. This inequality is inadmissible."

The effect of the factor can be quite significant, especially when people retire at an early age, because one of the bases of calculation is Brazilian life expectancy. "A woman who began working at 16 and contributed to social security for 30 years should be able to retire at 46, but the reduction factor will be more than 47%," Guerzoni says. In his analysis, moreover, the factor did not give the government the success it expected, which was that retirement would be postponed; "this has not happened." People have been ask-

ing for retirement as soon they are eligible and then continue working elsewhere after they retire, so in practice the pension becomes a second source of income. Guerzoni explains that "A person can retire, still work, and contribute to social security; and when she decides to stop, she can renounce her pension and apply for a larger or full retirement pension, nullifying the effect of the social security factor."

Two controversial options to end the social security factor have been put forward: the 85–95 formula, which provides that age plus years of contribution to social security should equal 85 years for women and 95 for men; and adoption of a minimum retirement age. The CUT, for example, accepts the 85-95 formula but "We are totally against the minimum age because it is harmful to people who start work early. They cannot retire by time of contribution due to the high turnover of labor," Henrique says. Senator Paim says he is not against the minimum retirement age, but there should be a transition rule so that workers are not harmed.

Ardeo supports a minimum retirement age and identifies another issue: the generous rules for granting pensions, which, for example, allows the family of a person who dies after contributed only one time, to receive a full pension benefit. "Messing with orphans and widows usually does not make good headlines, but something must be done," Guerzoni adds.

Public employees

Today, the largest social security deficit is in the public sector: about R$57 billion more was paid to 960,000 retired public employees in 2011 than was taken in for that purpose. To reduce this deficit, the government is working to get approval for the Supplementary Pension Fund for the Federal Public Employees (Funpresp), under which public employees (excluding the military) would contribute 11% toward the social security pension ceiling (R$3,691). Public employees who want pensions above the ceiling would have to contribute to a pension fund similar to private pension funds.

The initiative naturally raises questions. Guerzoni says, "The proposed fund has problems. One is the pension fund's autonomy to manage its resources. The political risk of these funds is significant. They may be used as instruments of government economic policy — this is an old story."

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Gabriel Leal de Barros

Funpresp would at first generate more federal spending, since all its effects will not be felt for 30 years. Unlike the RGPS, social security for public employees has more problems related to today and yesterday than tomorrow. Most public employees are retired or will retire on very favorable terms; for instance, their pensions receive the same adjustments

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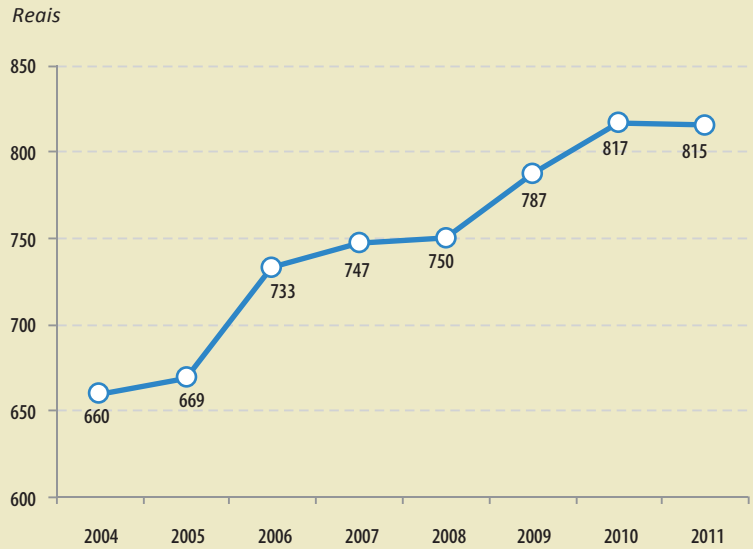
that are granted to active-duty public employees. This is not sustainable.

This issue is as controversial as the others but agreement seems to be closer: "Last year's discussions addressed most of the concerns put forward about the proposal," says Jaime Mariz de Faria Junior, Secretary of Supplementary Pensions of the Social Security Ministry. He believes Funpresp should be approved by both House and Senate by the end of March "... and we'll have a comfortable majority to pass."

[1] The social security factor was created to discourage early retirement: The lower the retirement age, the greater the discount on a full pension and hence the lower the value of the benefit.

Generous benefits have also helped to increase the social security deficit.

The average benefit has increased 23% in real terms since 2004.



Source: Statistical Yearbook of Social Security.