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Recent History, Perspectives and Challenges to Social Insurance: the Brazilian Case.

Marcelo Abi-Ramia Caetano[1]

Summary

The paper's aim is to describe the general background of pension policy and reform in Brazil. In order to provide the reader with an in-depth comprehension of the Brazilian pension system, this article starts by depicting the normative fundamentals of the three regimes of the Brazilian pension system: the Regime Geral de Previdência Social (RGPS), which is related to private sector workers; the Regime Próprio de Previdência Social (RPPS), where public sector employees are affiliated; and, finally, the optional complementary pension funds for high income workers in the RGPS. Besides these three regimes, there are means-tested and age-tested non-contributory social pensions. The paper then examines the contradictions and tradeoffs between the regime's fiscal costs, equity enhancement and poverty reduction. Most of the recent reforms in social insurance were motivated by the goal of reducing the total amount of pension expenditure. Nevertheless, the pension system presents a very complex structure regarding equity issues. Social security in Brazil is one of the most important policies for reducing poverty, especially for the elderly; however, depending on the analytical point of view, it can be classified as either progressive or regressive. For instance, from a geographical perspective, social insurance reduces regional inequalities as it transfers income from richer cities to poorer ones. However, it is regressive as it reallocates resources from the whole society to well-off public servants.

With this background in mind, it is possible to understand the continuous process of reforming social insurance in Brazil. The objectives of pension reform are threefold: enhancing equity, reducing fiscal and actuarial imbalance, and/or achieving more efficiency for the economy as a whole—for example, by establishing contributions less distortive to labour markets or by allowing the savings generated by pension funds to increase the investments in the economy. In Brazil, social security reforms are mostly motivated by fiscal issues and, to a lesser but not negligible degree, by equity perspectives. In fact,

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pension reforms in Brazil affected the middle class more than the poor. This redistribution from the middle strata to the poor was one the objectives of the pension reform.

Finally, it has to be recognized that although Brazil has gone through a number of reforms, many efforts and changes are still needed. Three main issues emerge: coverage expansion, reducing differences between public and private sector schemes and facing the future of an ageing population in a country that to date displays a young demographic profile, but where social insurance already represents a large fiscal burden. These are key matters to be debated in future reforms.

List of acronyms

DB	Defined Benefit
DC	Defined Contribution
IBGE	Instituto Brasileiro de Geografia e Estatística (Brazilian Institute of Geography and Statistics)
MPOG	Ministério do Planejamento, Orçamento e Gestão (Ministry of Planning, Budget and Management)
MPS	Ministério da Previdência Social (Ministry of Social Insurance)
LOAS	Lei Orgânica da Assistência Social (Brazilian non-contributory social pensions)
PAYG	pay-as-you-go.
RGPS	Regime Geral de Previdência Social (Social insurance regime for private sector workers)
RPPS	Regime Próprio de Previdência Social (Social insurance regime for public employees)
RMV	Renda Mensal Vitalícia (a type of Brazilian non-contributory social pensions that is being gradually replaced by LOAS)

I. Introduction.

Brazil has been passing through a number of social insurance reforms since the end of hyperinflation in the mid-90s. Two main objectives are evident in these reforms: equality, specifically through the harmonization of the pension rules for private sector workers and public servants (the latter group had more benevolent norms than the former); and alleviating the actuarial and fiscal imbalances of the Brazilian pension system, since its huge annual cost of more than 11 per cent of Gross Domestic Product (GDP) imposes a great fiscal burden in a relatively young country whose demographic dependency ratio is 9 per cent.[2]

Brazil has approved three constitutional amendments on its pension systems. The first one was in 1998, and the last two in 2003 and 2005. A law in 1999 changed the benefit formula into something that exhibits some similarity to a notional account.[3] Some basic features remained unchallenged like the earnings-related characteristics of the benefit formula, as well as its pay-as-you-go (PAYG) way of financing.

Great concern on the fiscal side is one of the main reasons that Brazil, unlike many other Latin American countries, has not embraced a transition from a PAYG to a funded pension scheme since the transition costs are seen as too high for a country deeply in need of fiscal equilibrium.[4]

Social insurance in Brazil is considered an important tool to reduce poverty, especially for the elderly. Regarding equity issues, it exhibits both progressive and regressive properties depending on the evaluation criteria. Hence, social insurance policy in Brazil deals with the difficult task of reducing actuarial-financial imbalances as well as the system’s regressive aspects, while still aiming at reducing poverty. These are crucial issues for a country known for its huge inequalities.

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[2] Demographic dependency ratio is the ratio of people aged 65 or older to the number of people aged 15-64.

[3] Notional accounts were implemented in Sweden, Italy and a number of Eastern and Central European nations in the 1990s. Concerning the benefit formula, notional accounts mimic a defined contribution pension scheme, where pension benefits are calculated on a strictly actuarial basis (with regard to life expectancy, gender, family size etc.) and depend on accumulated funds and current market interest rates; however the pension system is still financed in a PAYG way.

[4] Transition cost is the cost incurred by a country that changes its way of financing social insurance from PAYG to a funded system. It consists of the loss of revenue of the PAYG system once insured pay their contributions to the funded pillar or private pension fund.

The paper's aim is to provide an in-depth analysis of the reasons and results of the Brazilian pension reform's recent history. For this purpose, in addition to this introduction, the paper will be divided into five sections.

The starting point for a better understanding of a pension system is to know the fundamentals of its design. It concerns questions such as the system's target population, contribution rates, financing mechanisms, eligibility criteria to pensions, benefit formula and indexation rules. This is the purpose of the next section, where the different treatment regarding civil servants and private sector workers is emphasized.

Following the normative description, there is an analysis of the social and economic implications of the pension system. The Brazilian pension system faces the challenge of finding equilibrium between fiscal sustainability and social equity. This is the third section's theme. There will be an explanation of the reasons for the high expenditure level in the Brazilian system. The equity aspects are examined by analyzing where the system is progressive and where it is regressive.

With this background in mind, it is easier to understand the continuous process of reforming social insurance in Brazil. Section IV explores how recent reforms focused on equity and fiscal balance aspects, whereas efficiency considerations were not of major concern.

In spite of the many reforms, challenges remain. The final section presents some of these challenges. Social insurance policy in Brazil must still address problems concerning coverage expansion, the improvement of equity, and diminishing expenditure.

II. Overview on the Structure of the Brazilian Pension System

The Brazilian pension system is divided into three regimes. The first one is the Regime Geral de Previdência Social (RGPS) which covers private sector workers. The second is the Regime Próprio de Previdência Social (RPPS) where public sector employees are affiliated. Finally, there are optional complementary pension funds for high income workers in the RGPS. Besides these three regimes, there are means-tested and non-contributory social pensions which also require a minimum age of 65.[5]

In this section, there will be a description of each one of the three regimes regarding the fundamentals of its design. Due to the aims of this paper, the analysis for the first two regimes will be more detailed than the third. In this text, “design” means the rules concerning financing mechanisms, the beneficiaries and contributors of the regime, contribution rates, eligibility criteria, benefit formula, and pension indexation rules. In addition, the section presents data on the different regimes and short comments on non-contributory social pensions. Table 1 summarizes the main characteristics of theses schemes. Details are presented in the subsections below.

Table 1

Main Characteristics of Brazilian Pension Schemes

Programme	Qualifying Conditions	Benefit formula	Pension indexation
Pension Scheme for Private Sector Workers (RGPS)	Length of contribution: 35 years of contribution for men, and 30 for women. No age limits required. Old-age: 65 years old for men, and 60 for women.	Length of contribution: Wage average from July 1994 onwards times the social security factor. Old age: wage average from July 1994 onwards	Minimum wage if the benefit is equal to it; Price inflation otherwise.