The Political Economy of Reform in Brazil's Civil Servant Pension Scheme

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The opinions expressed herein are those of the author(s) and do not necessarily represent the official position of the Inter-American Development Bank.

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Introduction

Over the past two decades both developed and developing countries have implemented pension reforms. Reasons for reform include demographic transitions (with increasing life expectancies and growing elderly populations in many countries), labor market changes (with expanding informal sectors cutting into the payroll taxes needed to finance pension systems), and actuarial and financial imbalances of pension systems becoming more widespread due to the first two developments. Pension reforms must be handled carefully, because they may affect the income distribution between generations and among groups in the same generation.

Reform has been more successful in countries that have more homogeneous societies and that do not have a history of providing privileges to certain groups. By contrast, reform has been slow and painful in countries with political and representative systems unable to produce stable majorities in their congresses and where traditions related with heterogeneous and segmented pension systems have created political lobbies against reforms and impeded a clean political transition. In Italy, for example, these obstacles have stalled pension reforms started in the first half of the 1990s.

In Brazil most pensions are under the umbrella of a pay as you go (PAYG) system. Unlike many developed countries and even more than most other developing countries, Brazil also has a large, socially inclusive, noncontributory system that requires huge fiscal resources to finance expected benefits. In addition, there is a generous scheme for civil servants, as well as schemes that complement the coverage provided by the others. There is, however, considerable inequity among the benefits provided by these four main pension schemes. Thus pension reform in Brazil must both increase the coverage of the contributory schemes and reduce the inequity between the general pay as you go scheme and the privileged civil servant scheme.

In 1998 the Brazilian government implemented reforms to increase the financial sustainability of its pension schemes—seeking to contain pension deficits without hurting acquired rights. Changes to the pay as you go scheme included establishing a mechanism that defines benefits based on workers' ages and length of contributions, as well as raising the minimum retirement age for civil servants.

Despite these reforms, the country's pension schemes continued to generate rising deficits. So, in the second half of 2003 the administration of President Luis Ignacio (Lula) Silva introduced new reforms aimed at equalizing the more generous civil servant benefits with those offered by the general pay as you go system. These reforms were driven by the fact that the government was incurring R$50 billion a year in deficits to sustain high pensions for fewer than 3 million retired civil servants when it lacked resources to extend health and education coverage to poor citizens.

Reforms to the civil servant pension system are expected to cut the public deficit by 0.3–0.5 percent of GDP a year over the next five years and by more than 1.0 percent of GDP a year beyond that. These savings imply that while the civil servant system will continue to carry a sizable deficit over the medium term, it should decline over the long term. This chapter analyzes Brazil's pension

systems, focusing on the scheme for civil servants—including the need for and implications of the recent reforms.

Brazil's Pension System: An Overview

The Brazilian pension system was originally developed along the same lines as those in other Latin American countries. The first pension schemes started in the early 20th century,[1] with coverage increasing during the industrialization and economic development processes that spanned the 1930s to the 1960s. Those schemes, organized as pay as you go funds and managed mostly by the public sector, were unified in 1967 into a single fund managed by a new public institute (which in 1976 became the National Institute for Social Security - INSS) in an effort to achieve greater scale economies, increase equity, and improve financial administration. Unification did not, however, include the pension schemes for civil servants and military personnel, which retained independent administrations—guaranteeing many privileges for members.

Between the 1967 reform and the 1988 Constitution, few changes occurred in the administration of pension schemes for public and private employees. The most important change was the introduction, during the 1970s, of a noncontributory pension for elderly and handicapped persons lacking means to survive. In addition, in an effort to avoid short-term financial shocks in the early 1980s, the government made some adjustments to the pay as you go system for private employees. Those adjustments, based on parametric changes such as increasing contribution rates and capping or reducing benefits, did not change the structural trend of the pay as you go system toward a growing deficit.

A conceptual change to pension system rules was introduced with the 1988 Constitution, which defines a national social security system that guarantees all Brazilian citizens access to pensions, health care, and social assistance. The new pension system focuses on protecting people against poverty—especially those who lose their work capacity due to aging, health conditions, or disability, or who suffer the death of a spouse or parent (for children under 21). But this new conceptual framework did not introduce substantial changes in the way that Brazilian pension schemes were organized. It merely consolidated existing financing mechanisms,[2] solidified civil servants' privileges, and consolidated rights for noncontributing workers and the poorest elderly populations.

[1] The first pension law in Brazil (the Eloy Chaves Law), issued in 1923, covered railroad employees. Using the same model, many other profession-based pension schemes were created in the 1920s, including for commercial activities, public services, industry, and bank employees. By the end of the 1920s there were more than two hundred pension funds. In 1934 Getúlio Vargas's government increased the state's role in managing the pension system, creating seven public pension institutions—organized by branch of activity—that took on most of the contributors to the profession-based schemes.

[2] Under the new social security system, pensions are financed by payroll contributions; health care by taxes applied on gross sales, and social assistance by the net profit of firms and the financial sector.

Previously to 1998, the Brazilian pension system is composed of four schemes:

- *A noncontributory pension for rural workers, disabled people, and others*, with eligibility based on age (70 for men, 65 for women) or disability. This scheme, created in the 1970s, pays a monthly means-tested allowance equivalent to the Brazilian minimum wage (US$80) and is managed by National Institute for Social Security. It guarantees old age pensions for workers who spent their entire lives in the informal labor market, especially in rural areas.

- *A mandatory public pay as you go pension for private workers,* financed by payroll contributions. This scheme includes cross-subsidies to the poor and is based on defined benefits, with a monthly ceiling of R$1,562 (US$558 in June 2003). Minimum benefits are equivalent to the minimum wage. The system is also managed by the INSS. Employee contributions range from 8–11 percent of payroll, based on wage level. Employers contribute a flat 20 percent of payroll. The government contributes earmarked taxes to finance administrative costs, defray deficits, and cover contributions for employees of state enterprises. A 1998 reform to this scheme rose the minimum retirement age (from 53 to 60 for men and 48 to 55 for women) and extended the length of contributions (from 108 to 180 months). Compulsory retirement ages will be 70 for men and 65 for women after a transition period running from 1998 until 2011. During the transition, pensions will be based on the length of contributions, age, and years from implementation of the new rules.

- *A mandatory scheme for civil servants*, managed by federal, state, and municipal governments and by the armed forces and police. This scheme guarantees pensions equivalent to the worker's last salary before retirement. Pensions require 30 years of service for women and 35 for men, though beneficiaries can receive pensions equivalent to 80 percent of the last salary with 25 years of service for women and 30 for men. Previous time spent at a private job can be counted toward the service requirement—civil servants need to prove just one year of public service to receive the benefit. Until the 1998 reform neither civil servants nor the government (as employer) helped finance the system. All benefits were funded entirely by the public budget. The 1998´s reform required civil servants to pay 11 percent of their salaries to be enrolled in the system. In 2003 additional reforms were made to this scheme, witch will be described below.

- *Complementary pension funds*, which are optional, privately managed, mostly centered on capitalization, fairly regulated, and monitored by the Ministry of Social Security and Ministry of Finance. These schemes do not have standardized contribution rates or benefits. The benefits complement pay as you go pensions to a predefined ceiling, based on the rules for each pension fund. Most of these funds enroll only employees of the same company. Large companies in strategic sectors (electricity, oil, banks, telecommunications, steel production and decentralized public enterprises or institutions) account for most of the participants in this scheme.

As noted, the main purpose of this chapter is to analyze the structure, problems, and policies of the civil servant pension system, and all other sections are dedicated to those issues. To complement that analysis, the rest of this section describes some of the features of the three other pension systems.

NONCONTRIBUTORY PENSION

According to the 1999 National Household Survey (PNAD 1999), 26.7 million workers were private employees contributing to the pay as you go scheme and 4.8 million were public servants (civil and military) working for central, state, and municipal governments. Another 40.2 million workers—56 percent of the labor force—do not contribute to any system. Those workers are candidates to achieve the old age benefits of the noncontributory scheme if nothing happens to improve their occupational conditions.

In 2002 the pension schemes managed by Brazil's federal government paid benefits to 21 million beneficiaries.

As shown in figure 1, two-thirds of beneficiaries receive less than the minimum wage and more than three-quarters earn monthly benefits of less than US$160.

Even so, the Brazilian pension system, especially the noncontributory scheme, helps alleviate poverty. The population below the poverty line would be greater, especially among disabled and elderly populations, if the noncontributory pension did not exist.

Among 15 Latin American countries, Brazil has some of the broadest pension coverage for people over 60. Only Argentina and Uruguay cover larger portions of the urban elderly, and Brazil has the highest coverage of the rural elderly (table 1). This system has been important in containing rural-urban migration and increasing the income of the poorest families, especially in rural areas.

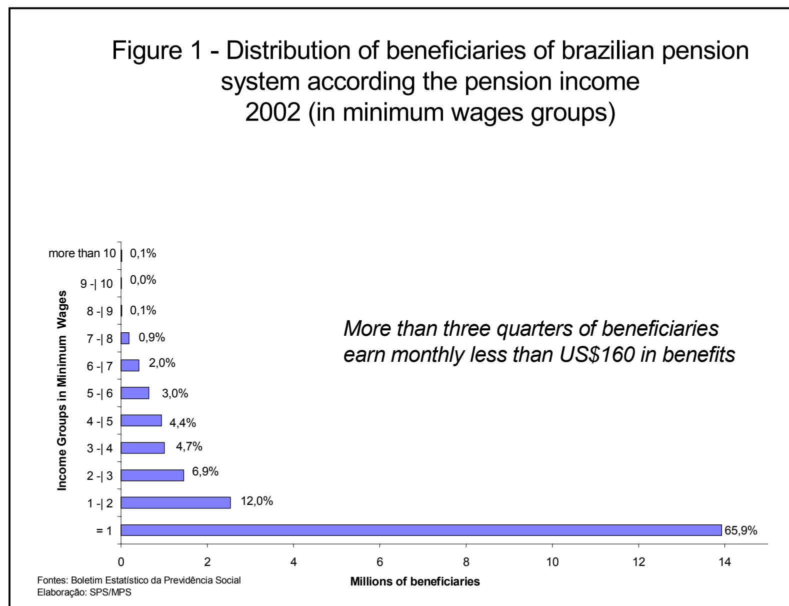


Figure 1 - Distribution of beneficiaries of brazilian pension system according the pension income 2002 (in minimum wages groups)

Table 1 - Pension coverage for people 60 and over and average monthly pension values in 15 Latin American countries, 1997

Country	Coverage (percent)		Value (multiples of country poverty line)	
	Urban	Rural	Urban	Rural
Argentina	67		2.3	
Bolivia	26	4	2.6	2.5
Brazil	62	75	3.2	1.7
Chile	61	48	3.5	2.8
Colombia	20	9	3.5	3.1
Costa Rica	40	19	3.5	3.1
Dominican Republic	16		2.9	
Ecuador	17		2.0	
El Salvador	18	3	2.2	1.7
Honduras	8	2	1.2	1.2
Mexico	23	7	1.3	1.6
Nicaragua	17		1.1	
Panama	48	19	4.6	5.0
Paraguay	21		2.6	
Uruguay	81		3.3	
Average	39	21	2.6	2.0

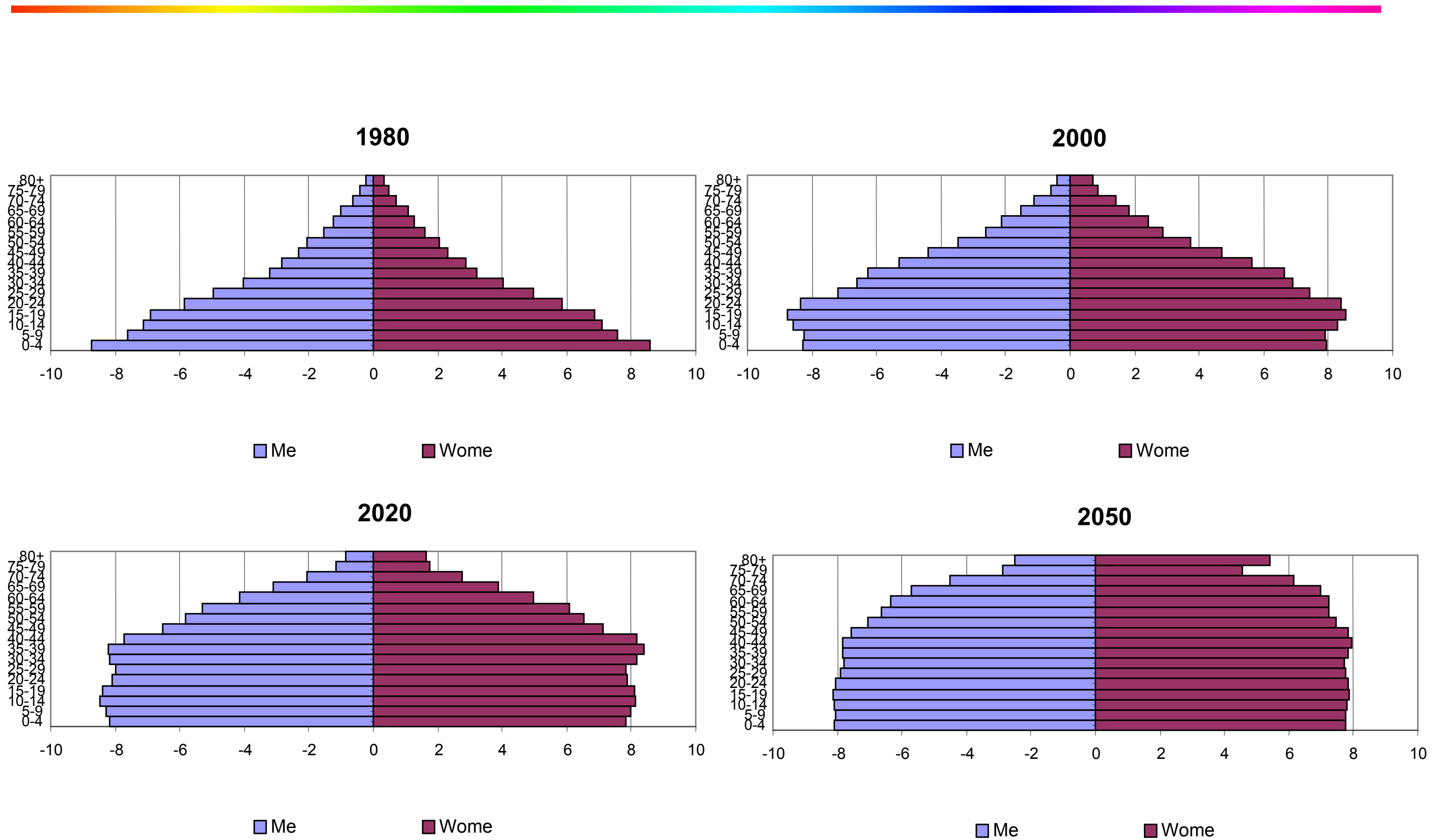
Source: CEPAL 2001, based on household surveys.

MANDATORY PAY AS YOU GO SYSTEM

Between 1994 and 2002 the number of rural pensioners increased from 5.8 to 6.9 million. The number of urban pensioners increased even faster. Several government changes on the pensions regulation, designed to avoid future problems in the compulsory pension scheme —such as increasing the length of required contributions and the retirement age and reducing the value of pensions—led many workers to retire earlier than expected. As a result the number of urban beneficiaries in the mandatory pay as you go scheme increased from 9.4 to 14.3 million between 1994 and 2002, in a context of low economic growth and increasing informal labor.

Many variables indicate that Brazil's compulsory pension system is approaching a crisis. Demography is no longer favorable to generous pension systems. Since the late 1950s Brazil has experienced a rapid demographic transition, resulting in a drastic reduction in population growth (from 3.0 percent a year in the 1960s to 1.4 percent in the 1990s). It is expected that around 2010–20, demographic growth will reach the population replacement level. In addition, fertility rates in Brazil fell from 4.3 children per woman of reproductive age in 1960 to 1.9 in 2000, and are expected to be around 1.4 in 2040. Additional life expectancy at age 60 is 18 years and at 70 is about 11 years.

Figure 2 Population pyramids in Brazil, 1980–2050 (million of people)



Source: IBGE Demographic Census (several years)
Elaboration: SPS/MPS

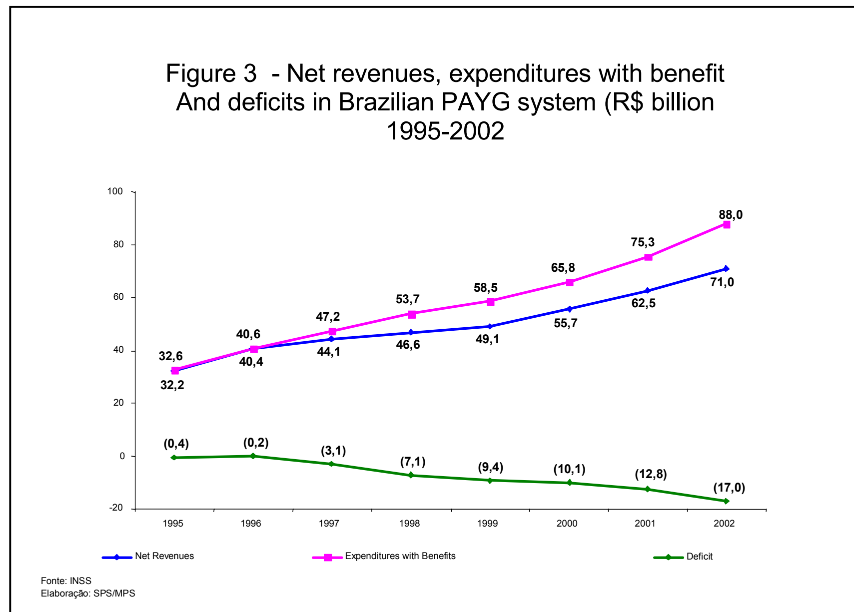
Over the next 50 years the Brazilian population will age significantly (figure 2). Consequently, dependency ratios will decrease as well.[3] Within the next 20 years the dependency ratio will likely fall below 2, and by 2030 it will be almost 1—meaning that just 1–2 workers will contribute to sustain each retiree or pensioner under the PAYG system. .

Moreover, the informal labor market grew considerably during the 1990s, narrowing the possibility of maintaining financial sustainability in the pay as you go scheme. As a share of the labor force, the formal labor market fell from 50 percent in 1994 to 45 percent in 2002.

During the 1990s these demographic and labor markets trends led to growing deficits in the compulsory pay as you go system (figure 3). Since 1995 benefit expenses have exceeded payroll contributions, and by 2002 the deficit had reached R$17 billion (about US$6.0 billion). (Part of this deficit is due to the noncontributory system, which should be accounted separately.) Without changes, the deficit of the compulsory pay as you go system is expected to grow from 1.3 percent of GDP in 2002 to 1.7 percent in 2020, assuming moderate annual economic growth of about 2 percent. If economic growth is slower, the deficit will be even larger. Thus steps need to be taken to achieve future financial equilibrium in the pay as you go scheme.

Part of the pension deficit is due to fiscal rules that forgo the collection of RS$8 billion a year—almost half of the annual deficit. Those rules provide unfair privileges for some employers, employees, and nonprofit organizations.[4]

Figure 3 - Net revenues, expenditures with benefit And deficits in Brazilian PAYG system (R$ billion 1995-2002



Fonte: INSS
Elaboração: SPS/MPS

[3] During the 1970s the dependency ratio of Brazil's pay as you go scheme was about 4 (meaning 4 contributors for each retiree or pensioner), but by 2000 it was around 2.

[4] The PAYG system exempts or reduces tax contributions for philanthropic organizations, rural employers and employees, domestic employees, professional soccer clubs and associations, and others.

COMPLEMENTARY PENSION FUNDS

Brazil is among the few Latin American countries with voluntary private pension funds. Most complementary pension funds in Brazil are linked with capitalization schemes. The first such funds were created in the 1960s. Since then, several regulations have improved their portfolios and performance. The most recent regulation (Law 109, issued in May 2001) established two types of operating arrangements for these funds: closed entities, represented by employees of a company or groups of companies with specific collective benefits drawn for that group, and open entities, accessible to whoever subscribes and defray their own benefit plan.

In 2002 the number of participants in complementary pension funds reached 1.7 million, with 4.3 million dependents and 0.6 million retirees. Enrollees represent less than 4 percent of the Brazilian population. Still, these funds play an important economic role, especially in increasing the country's long-term savings. Between 1990 and 2002 the assets of complementary funds increased from 2.2 percent to 14.3 percent of GDP, or more than US$68 billion. Most assets are held in investment funds (50 percent), stocks (19 percent), and public bonds (12 percent).

Although complementary pension funds need a few regulatory adjustments,[5] these adjustments will probably not be made until after the changes needed in the mandatory PAYG scheme. As complementary institutions, these funds need to adjust their benefit schemes in line with the shape defined by the pay as you go system.

MAIN SHORT-TERM CONCERNS FOR BRAZIL'S PENSION SYSTEM

The main risk facing the Brazilian pension system is the deficit in the PAYG scheme. This deficit has been increasing since the mid-1990s, and the 1998 pension reform was unable to avert this trend.

Brazil's pension system is fragmented and has little integration among its four main schemes. This situation leads to coverage duplications. Many people accumulate rights to pensions as both private employees and civil servants. Even many civil servants earn two or more pensions simultaneously when they retire as federal and state or municipal employees. The 1998 reform forbade such accumulation.

There is enormous disparity in the benefit rules and requirements for different kinds of employees—especially for civil servants, who are a privileged group. And among civil servants, some groups (such as members of Congress and judiciary employees) receive pensions higher than their last salaries. This situation increases social inequity.

The Brazilian government has tried, at different points in recent history, to introduce reforms to reduce privileges and increase the system's long-run sustainability. But the reforms implemented in the 1990s did not achieve much. Interest groups, such as civil servant and trade unions, exerted pressure to keep privileges and avoid the rational solutions needed for a sustainable pension system.

[5] Most needed adjustments are related to administration costs, insurance premiums, asset portfolio composition (especially regarding the possibility of allowing foreign investments), and nature of benefits (defined contribution versus defined benefit or mixed schemes).

Civil Servant Pension Scheme

Public employees can be registered as civil servants or contracted under the private pay as you go system. In 1995 around 87 percent of federal, 67 percent of state, and 54 percent of municipal public employees were civil servants. According to constitutional rules, the hiring process for civil servants is provided by public competition. Once approved, selected and hired, civil servants have special rights, including a different pension system.

The civil servant pension scheme in Brazil is a complex chain of national and local systems (and interests) that includes many federal employee categories (executive, legislative, judiciary, armed forces) at different government levels; 27 state pension systems (including the Federal District) with the same complexity of the federal level, only replacing the armed forces with state police (civil and military); and employees of 2,140 municipalities.[6] The pension systems for these categories are regulated under law issued in the beginning of the 1990s, (Regime Jurídico Único, or RJU) created to protect all civil servants nationwide under almost the same basic rules.

The total number of civil servants protected by RJU rules is unknown, but in 1999—taking into account the federal, state, and state capital levels—there were 3.7 million active employees in the system, 1.7 million retirees, and almost 1.0 million pensioners (table 2).[7] The dependency ratio is higher at the federal level, reflecting the smaller number of active employees relative to retirees and pensioners. At the state and municipal levels the dependency ratios are more reasonable. Still, there is not much confidence in the future sustainability of those systems.

The main advantages of pension rules for civil servants are:

- *Higher pension value.* Given the same length of service, civil servants receive pensions equivalent to the last salary received. Private employees receive pensions calculated as an average of the 36 highest monthly salaries in the five years before retirement, limited by a ceiling of 10 times the minimum wage (about US$1,200).

Table 2 Employees, retirees, and pensioners in the civil servant pension scheme, 1999

Government level	Active civil servants (1) (thousands)	Retirees (2) (thousands)	Pensioners (3) (thousands)	Dependency ratio (1)/(2)+(3)
Federal	852.0	532.6	401.3	0.91
State	2,561.0	1,035.6	514.2	1.65
State capitals	332.1	93.2	44.4	2.41
Total	3,745.1	1,661.4	959.9	-

Source: Brazil, Ministry of Social Security, 2002.

[6] Public employees of state companies, foundations, and the other 3,150 municipalities are not protected by the RJU.

[7] Brazilian rules define retirees as former workers receiving a pension and pensioners as widows or dependents of dead retirees.

Table 3 Differences of pension rules for civil servants relative to private employees

Type of benefit	Private employees (Constitutional amendment 20, December 1998)	Civil servants (Constitutional amendment 20, December 1998)
Pension by length of service	Transitional rules: a) Contribution period: 35 years (men) and 30 years (women) b) Minimum age: 53 (men) and 48 (men) Post-transitional rules: a) Same b) Minimum age: 60 (men) and 55 (women) Benefit value: 80 percent of the average of the 36 highest monthly salaries in the past five years, adjusted by the provisional factor[a] Ceiling of benefit value: R$1,200 in December 1998 (actualized by inflation rates)[b]	Transitional rules: a) Same b) Same Post-transitional rules: a) Same b) Same Benefit value: last salary Ceiling of benefit value: none
Pension by age	60 years (men) and 55 years (women)	Same
Length of service to get the benefits assured by the system	35 years (men) and 30 years (women)	10 years (to get the last salary benefit) and 5 years (to incorporate fees and commissions for management positions). The remaining 25 years can be spent as a worker or self-employed enrolled in the pay as you go system
Benefit value parity with salaries of active employees	Benefits actualized based on specific price indexes for retired people	Full parity with salaries of active employees

a. The provisional factor is a formula used to calculate the benefit value at the time an individual retires, based on age and length of contributions.
b. The government has proposed raising the ceiling to R$2,400 to restore the original reference value of 10 minimum wages.
Source: RJU Law and Regulations

- *Shorter contributions to achieve a full pension.* Civil servants have to prove that they worked just 10 years as public employees to achieve a pension equivalent to the last salary. (The remaining 25 years could be accounted as a worker or self-employed enrolled in the PAYG system.) The monthly amount of all fees and commissions received during over five years of work as civil servant when the time is fully incorporated in the monthly benefit value.

Table 4 shows the combined payroll income, spending, and deficit of the civil servant pension scheme for the federal, state, and municipal levels (including police and military) during 1995–2002. Deficits have been growing, reaching 4.2 percent of GDP in 2002. Most of these deficits resulted from the absence of civil servant contributions until 1998, when a contribution of 11 percent of payroll was established. Deficits have also risen as a result of slow GDP growth in a context of moderate expansions in benefit spending due to the aging of civil servants and the consequent increase in retirees and pensioners.

Table 4 Payroll income, benefit spending, and deficit of the civil servant pension scheme 1995–2002

Year	Payroll income		Benefit spending		Deficit	
	R$ billions	Percentage of GDP	R$ billions	Percentage of GDP	R$ billions	Percentage of GDP
1995	6.2	1.0	25.4	3.9	19.2	3.0
1996	6.4	0.8	33.7	4.3	27.3	3.5
1997	6.6	0.8	37.1	4.3	30.5	3.5
1998	6.9	0.7	41.8	4.6	34.9	3.8
1999	8.1	0.8	44.0	4.6	35.9	3.7
2000	6.9	0.6	52.0	4.8	45.2	4.1
2001	6.3	0.5	56.4	4.8	50.1	4.2
2002	7.2	0.6	61.6	4.7	54.4	4.2

Source: Brasil, Ministerio da Fazenda, 2003

The federal government has always argued that the system deficit is a consequence of generous benefits and low employee payroll taxes. But the government has never defined, calculated, or made explicit the contributions to be paid by governments (as employers) as a counterpart of civil servant contributions. Some analysts claim that even if the government contribution were twice the size of the civil servant payroll tax, the system would still run a deficit. But the current situation most likely never would have occurred if financing rules had been defined earlier. Pay as you go systems must have independency, transparent accounts and clear mechanisms to finance benefits and identify deficit trends. That never happened with Brazil's civil servant pension system.

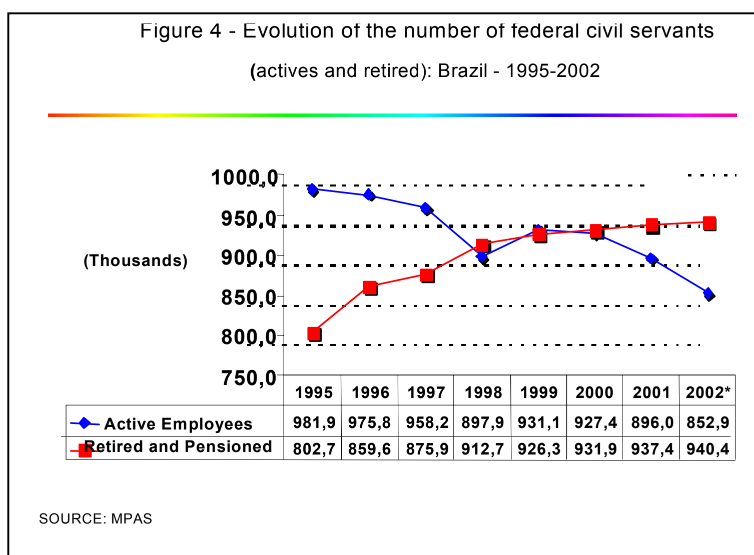
Each level of government experiences different outcomes from the system's performance and has different motivations for supporting reforms. Table 5 shows that the weight and dimension of the deficit differ at each level of government. Though the federal deficit is larger than that at other government levels, in all cases the deficit represents a large proportion of spending on the pension system. Another way to analyze the deficit is as a share of fiscal revenues. In 2000 the federal government spent 18 percent of its revenues financing the civil servant pension deficit. State governments spent 13 percent, and municipalities just 3 percent. Given these variations, it is useful to analyze the performance, issues, and needs of the civil servant pension scheme at the federal, state, and municipal levels.

Table 5 Measures of the civil servant pension deficit by government level 2000

(percent)

Government level	Share of system deficit	Deficit as share of pension spending	Deficit as share of fiscal revenues
Federal	57	89	18
States	36	78	13
Municipalities	7	87	3
Total/average	100	85	

Source: Brazil, Ministerio da Fazenda, 2003.



	1995	1996	1997	1998	1999	2000	2001	2002*
Active Employees	981,9	975,8	958,2	897,9	931,1	927,4	896,0	852,9
Retired and Pensioned	802,7	859,6	875,9	912,7	926,3	931,9	937,4	940,4

Federal system

The federal civil servant pension scheme is the most imbalanced among the three levels of government. Its dependency ratio is less than 1, seriously undermining its financial sustainability. Accordingly, its reform is a top priority for the federal government.

As shown in figure 4 in recent years the number of federal civil servant retirees and pensioners has increased sharply while the number of active employees has decreased. Thus the system can no longer be sustained by payroll contributions, and requires urgent adjustments to avoid growing public deficits.

The age structure of current civil servants does not bode well for alleviating the pension deficit: only 29 percent of federal employees are under 41. Moreover, the average age of new federal employees has been rising, from 31 in 1995 to 35 in 2002. Nearly half of federal civil servants are aged between 41 and 50, and a quarter is in the retirement range (51 and over). As a result the number of new retirees is expected to increase over the next few years.

Table 6 Average monthly pension benefits for federal civil servants and private employees, 2002 **(R$)**

Professional category	Benefit
Federal civil servants	
Executive branch	2,171
Federal judges	11,862
Central Bank	6,662
Armed forces	4,024
Legislative branch	6,969
Judiciary branch	7,308
Private employees (pay as you go system)	
Average pension by age [a]	713
Average pension by length of service [b]	232
Average pension of pay as you go system	362

a. Provided at age 70 (men) or 65 (women), independently of length of service.
b. Provided after 35 years of service (men) or 30 years of service (women).
Source: Brasil, Ministério da Fazenda, 2003.

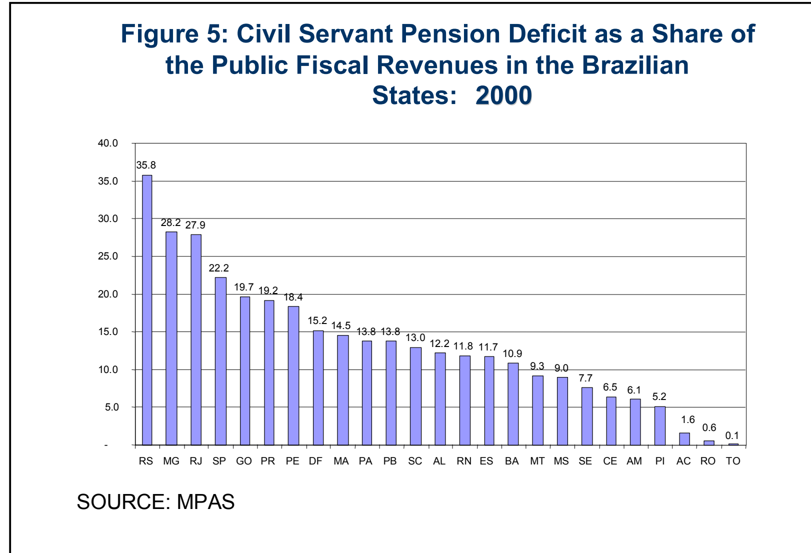


Figure 5: Civil Servant Pension Deficit as a Share of the Public Fiscal Revenues in the Brazilian States: 2000

SOURCE: MPAS

Another issue is the high heterogeneity of civil servant benefits across professional categories. Table 6 shows the average pension benefit for different groups of federal civil servant retirees and for private workers registered with the pay as you go system. While the average pension benefit for federal judges is five times that for retirees from the executive branch, the benefit for federal executive-branch civil servants is almost 10 times that for retirees based on length of service under the PAYG system. But some of the groups receiving generous benefits (such as judges, the armed forces, and members of Congress) have considerable political power—inhibiting the likelihood of extensive reform.

State systems

As noted, relative to the federal government, state governments spend a smaller share of fiscal revenues to finance the civil servant pension deficit. There are many reasons for that: (a) States started their civil servant pension systems at different times. So, while some states have older systems with large deficits, many have young systems without deep actuarial imbalances; (b) Some states began implementing civil servant pension reforms in the late 1990s and are now in better financial shape then others; c) Different rules about benefits and contributions in each system have influenced the evolution of the balance between spending and income.

Figure 5 shows civil servant pension deficits as a share of fiscal revenues in Brazilian states. In some, such as Rio Grande do Sul, Minas Gerais, Rio de Janeiro, São Paulo, and Goias, the share of deficit spending is higher than that by the federal government. In others, such as Tocantins, Rondonia, and Acre, the deficit does not compromise too many public revenues.

In 2000 the 26 (excluded Tocantins State that was created in the end of last decade) Brazilian states had 2.6 million active civil servants and 1.0 million retirees (see table 2). Only 8 states had dependency ratios of less than 2 under their civil servant pension systems, and all were among the richest states (figure 6). Many northern, northeastern, and midwestern states do not face short-term risks of financial crises in their civil servant systems. So, despite the need for measures to restructure the system and avoid future imbalances, the considerable heterogeneity among states

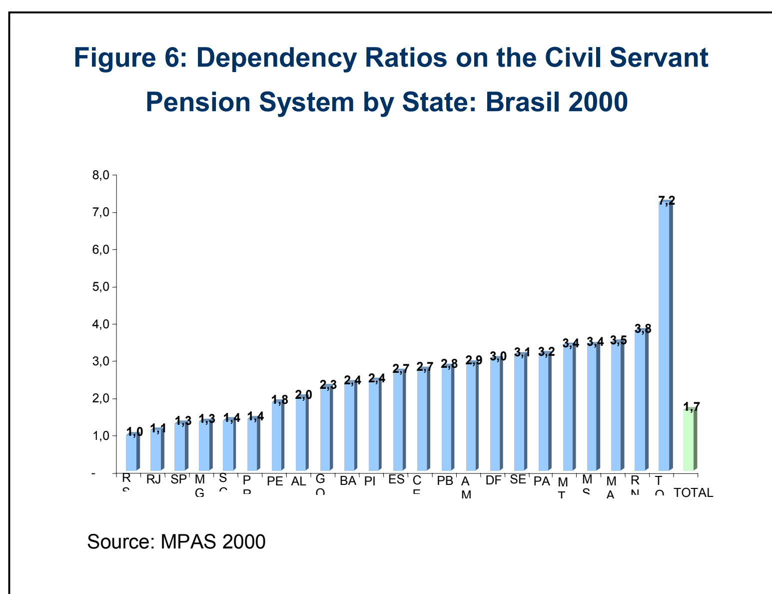


Figure 6: Dependency Ratios on the Civil Servant Pension System by State: Brasil 2000

Source: MPAS 2000

makes it difficult to align the opinions of state authorities when it comes to civil servant pension reform.

Municipal systems

Municipal civil servant pension systems were created and expanded later than the federal and state systems. There is little timely information on the total number of beneficiaries of municipal systems. The first of these systems, created in state capitals, have 332,000 active civil servants and 138,000 retirees and pensioners. The dependency ratio of these systems (2.4) is much more comfortable than those at the federal and state levels.

Many municipalities, however, are increasingly using the PAYG system for their employees. Table 7 shows the distribution of public employees in the civil servant and pay as you go systems by government level.

Municipalities contract fewer employees under the civil servant system because federal rules discourage them from doing so, based on the argument that using the PAYG system will help ensure the long-run sustainability of their local administrations. Even so, some municipal governments are running deficits under the PAYG system due to fiscal imbalances, falling tax revenues, and cash shortages.

Table 7 - Pension system coverage for public employees by government level 1999 (percent)

Government level	Share of employees		Share of payroll	
	Civil servant system	Pay as you go system	Civil servant system	Pay as you go system
Federal	86.9	13.1	93.3	6.7
State	66.7	33.3	88.8	11.2
Municipal	54.4	45.6	71.5	28.5

Source: Brasil, RAIS/MTb (several issues)

Municipal deficits under the civil servant pension scheme are smaller than those at the federal and state levels. In 2000 only 3 percent of municipal revenues were used to cover these deficits—much less than at the federal and state levels (see table 5).

The 2000 Fiscal Responsibility Law introduced new rules to discipline municipal and state spending on public pensions. The law imposed new obligations in areas such as transparency, long-term planning, financial and actuarial balance, and periodic publication of the financial state of pension system accounts.

The administration of President Fernando Henrique Cardoso also introduced many other changes to promote fiscal discipline and prevent the creation of new civil servant pension systems. (More than half of municipalities do not have such systems.) The new rules are crucial to the sustainability of existing systems, and include:

- Prohibiting workers from collecting more than one public pension.
- Providing the same benefits as under the PAYG system.
- Separating accounts for health expenditures and pension benefits.
- Forbidding systems from making loans to civil servants.
- Limiting net spending for retirees and pensioners to 12 percent of municipal income.
- Creating municipal pension funds to guarantee the future payment of benefits.

Reform of the Civil Servant Pension System

In December 2003 the Brazilian Congress approved a parametric civil servant pension reform (constitutional amendment 41). This section describes the debate that preceded the amendment's approval and the changes it introduced.

The Brazilian Partido dos Trabalhadores (Workers Party) won the most recent (2002) national elections. The new president, Luis Ignacio (Lula) Silva, was elected based on his opposition to the "neoliberal" reforms implemented by former President Cardoso. Civil servants, as a group, have always been among the strongest supporters of the Workers Party and were a crucial part of the social alliance that led to Lula's election. Civil servants expected that any further reforms would reduce their social privileges, undermine their political power, or both.

But in an internally and externally adverse environment, it is sometimes difficult for a government to sustain the privileges of interest groups—no matter what its political debts. Six months before the elections, Brazil's economy experienced hard times. The risk rate for foreign investments skyrocketed due to uncertainty about future economic policies. To ease this uncertainty, Lula's government has had to demonstrate its commitment to macroeconomic stability and public deficit control.

To prove these commitments in the long run, the government had to pursue an agenda of reforms, focusing on two sectors: pensions

(especially civil servant pensions, to reduce public deficits) and taxes. These were the main battles facing Lula's government in 2003, with high risks of losing political support.

Since January 2003 the new government has been trying to reach national consensus on the need for pension reform. President Lula has argued that civil servant pension reform is crucial to achieving social justice and balancing public accounts. During 2002 the federal civil servant pension system spent R$33 billion on fewer than 1 million beneficiaries, while the pay as you go system spent R$88 billion (less than 3 times more) on 18 million beneficiaries (more than 18 times more). In 2002 federal, state, and local governments spent R$62 billion on benefits for retired civil servants. But payroll contributions for civil servants were just R$7 billion—generating a deficit estimated on R$55 billion.

Given this situation, President Lula's government has defined three main goals for civil servant pension reform: (i) achieving better balance in the system and guaranteeing long-run stability, (ii) reducing social imbalances in the use of public funds by providing larger income transfers to the poorest families, and (iii) reducing pressures to cover system deficits and freeing public resources to support economic growth. Based on these goals, in March 2003 the president and the governors of 27 states endorsed the Brasilia Charter, which:

- Elaborates joint proposals to reform civil servant pension schemes at the federal, state, and municipal levels, seeking to reverse the systems' actuarial and financial imbalances.
- Proposes new rules for benefits (minimum age, minimum time working, and so on).
- Provides for government contributions equivalent to the minimum contributions of active civil servants.
- Imposes a ceiling on benefits for civil servants (or different ceilings based on professional category and government level).
- Creates complementary pension funds for public employees as a way to increase the pension value over the ceiling value.
- Supports studies at the state level to evaluate the impact of these measures on the system's equity and sustainability.

To build the alliance needed to approve these measures in Congress, Lula's government had to deal with many special interest groups and engage in political debates in many institutional arenas.

In the executive branch the main actors were the Ministry of Presidential Cabinet, Ministry of Finance, the Ministry of Social Security and the Ministry of Planning, which helped advance the proposed changes. Other parts of the federal government were silent, and some indicated their unhappiness with the proposals. In a strategic move, the government proposed the reforms only for civil servants, excluding the armed forces.

In the legislative branch the actors were members of Congress. The government party (Workers Party) was split into groups for and against the reforms. But opinions were also divided in other parties. The strategy of the government leadership in Congress was to create a punitive environment for any member of the Workers Party who did not support the reforms, and to develop alliances and bargaining tools with members of other parties to generate support.

In the judiciary branch there was clear-cut opposition to the proposed reforms—

especially by magistrates and judges, who will see their privileges cut as a result.

State governors were generally in favor of the reforms, and municipal mayors were not called on to participate in the process.

Within civil society there was enormous opposition by active civil servants, who are directly affected by the increased length of service required to receive benefits and the reduction in the value of their future pensions. Retirees were also opposed, because the reform reduces the value of their benefits. Given that active civil servants, retirees, and pensioners represent 6.4 million persons and each is able to influence two other adults, there was a potential of 20 million voters opposed to the pension reforms. Moreover, almost all are among the richest fifth of the Brazilian population and have a strong capacity to influence public opinion.

Although the main arena of debate was Congress, another important arena was the mass media (press, television, and so on), where the public opinion debate—which was decisive in influencing the behavior of members of Congress—took place.

In April 2003 the government sent Congress the constitutional amendment proposal (PEC 40-2003) on pension reform. In August the Deputies chamber approved an alternative amendment (PEC 40A-2003), but in the Brazilian bicameral system this amendment had to be approved by the Senate to be enacted into law. The Senate introduced some changes and approved it in October. Based on these changes the combined Congress approved a new amendment (PEC 41-2003) in December 2003. The changes introduced by the amendment have consequences for the following actors.

Pensioners and retirees

- Current retirees and pensioners (including those who have rights to claim benefits) will contribute the same payroll tax as active civil servants (11 percent), except for those under the ceiling for income tax exemption.

Active civil servants (when retired)

- Will pay the same payroll tax as paid as during employment (11 percent), except for those under the ceiling for income tax exemption.

- Federal judicial system civil servants will receive a pension ceiling equivalent to the highest salary received by a Supreme Court minister. For state judicial system civil servants, the ceiling will be equivalent to 90.25 percent of the higher salary of a Supreme Court minister.

- Regular retirement age will increase from 53 to 60 (men) and from 48 to 55 (women). Minimum length of service to retirement did not change: 35 years (men) and 30 years (women). Men and women can still retire younger than the regular retirement age at 53 (men) and 48 (women) with 35 years and 30 years of service, respectively. But in both cases a reduction factor will be applied to the benefit value equivalent to 5 percent for each year until 60 (men) and 55 (women). In other words, the benefit value for those retired at 53 (men) and 48 (women) will be equivalent to 65 percent of the last salary received before retirement. This new rule creates economic incentives for later retirement.

- To count the length of service period as 35 years of contributions in private or public pension schemes, at least 20 years

of contributions must be in public schemes and 5 years in the last civil servant position.

- Will keep the right to claim, for length of service retirement, 30 years (men) and 25 years (women) of service for civil servants hired before December 1998.

- Civil servants hired before December 1998 that achieve the requirements of regular retirement age and minimum length of service will receive pensions equal to the last salary received before retirement (benefit integrity principle). They will also get parity in readjusting their pensions with the salaries of active civil servants.

Future civil servants

- Will have their benefits calculated according to the contributions effectively completed (including in the pay as you go system).

- If federal, state, or municipal governments create complementary pension funds, civil servants will have the rights to contribute in order to complement benefit values when their salaries are over R$2,400.

- Will contribute, when retired or pensioners, the same payroll tax as active civil servants (11 percent), except for those under the ceiling for income tax exemption.

- Will be subject to the ceilings and sub-ceilings established by law, including for accumulated received benefits.

- Pension value for pensioners will be the same as for retirees until the limit of R$2,400, plus 70 percent of the amount beyond this limit.

- Will lose the right of parity between pensions and salaries of active civil servants.

- Governments at all levels will create complementary pension funds for civil servants. Those funds will be publicly managed in a defined contribution scheme.

Military personnel

- Will be subject to the ceilings and subceilings established by law, including for accumulated received benefits.

Police and firemen

- Will be subject to the ceilings and subceilings established by law, including for accumulated received benefits.

- Pension value for pensioners will be the same as for retirees until the limit of R$2,400, plus 70 percent of the amount beyond this limit.

- Can no longer use the length of service time declared by affidavit basis to count toward retirement (for current and future civil servants).

For all those insured in the pay as you go system

- Ceiling of contributions and benefits increases from R$1,200 to R$2,400.

- Coverage of safety and occupational health revert to the Ministry of Social Security, without participation of the private sector.

Final Comments and Concerns

Many topics related to the new constitutional amendment on pension reform will continue to raise complaints among certain groups of civil servants. For example, most judges on the Brazilian Supreme Court do not agree that is acceptable to collect payroll contribution for retirees. But on the other hand, the government has argued that the civil servant pension scheme is based on solidarity, not capitalization. For this reason the payroll contribution can be paid indefinitely as a tax, including by retirees.

Another polemical point of the newly approved reforms is the breach of contract on acquired rights for active civil servants expecting to retire in the next few years. This is particularly unfair when compared with the transitional rules for private employees implemented by the 1998 pension reform. Many political actors consider this breach of the rules a flagrant case of disrespect for acquired rights.

Finally, while public sector pension reform was the government's most urgent and difficult task, deficits in the private pension system must also be addressed. These deficits are growing, especially because benefits vary proportionally with annual increases in the minimum wage.

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