THE MARKET ORIENTATION OF SOCIAL SECURITY:
THE BRAZILIAN CASE

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Avaliação dos Programas da Rede de Proteção Social do Ministério da Educação. Convênio Ministério da Educação (1999).

Avaliação Comparativa do Programa TV Escola. Convênio Ministério da Educação (1999).

O Setor Saúde e o Complexo Econômico da Saúde no Brasil. Convênio MARE/CAPES/FINEP (1999).

Descentralização dos Serviços de Saúde no Brasil: A Efetividade do Gerenciamento e do Gasto nos Municípios Habilitados para a Gestão Semiplena no Período de 1994-1997. Convênio Ministério da Saúde (1998 - 1999).
Impactos Sócio-econômicos das Políticas de Transporte sobre as Condições de Vida da População da Grande São Paulo. Convênio (1998 – 1999).

Análise Qualitativa de Programas Inovadores do Comunidade Solidária. Convênio PNUD/Conselho da Comunidade Solidária (1998 – 1999).

Avaliação da Descentralização de Recursos do FNDE e da Merenda Escolar. Convênio INEP/MEC (1997-1998).

Desenho e Implantação de Estratégia de Avaliação dos Programas Sociais Prioritários do Governo Federal Brasileiro. Convênio BID/UNESCO/Gov. Brasileiro (1998).

A Educação básica e secundária no Brasil: evolução recente. Convênio MEC/UNESCO (1997).

Avaliação da Descentralização das Políticas Sociais no Brasil: Saúde e Educação Fundamental - estudos municipais. Convênio Cepal (1997).

Avaliação do Processo de Implementação do Projeto "Inovações no Ensino Básico" e de algumas Medidas da Escola-Padrão no Estado de São Paulo. Convênio BIRD (1994/1996).

Estratégias para Combater a pobreza no Brasil: Programas, Instituições e Recursos. Convênio BID/CIEPLAN (1994).

INTRODUCTION

Although market-oriented proposals for retirement income protection reform have been present in the Brazilian social agenda since the last decade, they have become increasingly relevant in recent years. Since the 1980's, reform projects have advocated the *benefit-provision demonopolization*; that is, they are oriented towards the creation of a market for the provision of mandatory complimentary benefits in which both private and public institutions (such as private and public banks) would compete. The main issues at the center of the proposals for and opposition to such a project are: the definition of the ceiling for pension values; the constitution of one or two levels of mandatory complementary benefits; the privileges under existing special regimes for civil servants and - last, but not least - the constitution of a more reliable and efficient regulatory framework than the present one. It is from this perspective of reforms and transformations that the Brazilian social security system is examined in this paper.

THE BRAZILIAN SOCIAL SECURITY SYSTEM: A BRIEF INSTITUTIONAL HISTORY

The origins of Brazilian public social security system may be traced to the 1930's, when the IAP's (Institutos de Aposentadorias e Pensões) were created. These institutions covered risks related to temporary or permanent loss of ability to work (old age, sickness, disability, and survivors' benefits) and organized health-care services. During the previous decade, several organized segments of the labor movement had succeeded in obtaining some state regulation of the relations in the workplace, including legislation regarding work-related disabilities, and the creation of mutual-aid societies organized along traditional anarchist lines.

Structured by occupational category, according to local and regional differences, the IAP's created a heterogeneous system of benefits. After many attempts and despite strong resistance, this situation was changed in 1961, when the Social Security Reform Law (LOPS- Lei Orgânica da Previdência Social) provided uniform benefits for all salaried urban workers registered in the benefit system.

A new centralizing thrust took place in 1967, with the creation of the National Social Security Institute (INPS-*Instituto Nacional de Previdência Social*) which unified the IAP's.

However, the creation of the National System of Social Security and Welfare (SINPAS-*Sistema Nacional de Previdência e Assistência Social*) in 1977 introduced extensive restructuring. Under the administration of a new Ministry of Social Security and Assistance (MPAS- *Ministério da Previdência e Assistência Social*), SINPAS was composed of six units: the Social Security Financial Administration Institute (IAPAS-*Instituto de Administração Financeira da Previdência Social*), the accounting agency for the entire system; the Social Security Data Processing Company (DATAPREV-*Empresa de Processamento de Dados da Previdência Social*), a data processing and analysis firm; the National Social Security Institute (INPS-*Instituto Nacional de Previdência Social*), responsible for the distribution of benefits; the Brazilian Social Aid League (LBA-*Legião Brasileira de Assistência*) and National Children's Welfare Foundation (FUNABEM-*Fundação Nacional de Bem-Estar do Menor*), two social aid organizations; and INAMPS, (Instituto Nacional de Atendimento Médico da Previdência Social) the administrative unit responsible for public health services.

In this manner, a superstructure was constituted with central control at the ministerial level, but functionally decentralized through public agencies and institutes that gained increasing autonomy. By the late 1970's, around 250,000 employees worked in this system.

The operational and financial mechanisms of the three traditional areas of the social security system - pension benefits, health services and social assistance services - emerged from this process with clearly defined and independent profiles.

GENERAL CHARACTERISTICS OF THE PUBLIC AND PRIVATE SECTORS OF SOCIAL SECURITY IN BRAZIL

The organizational characteristics and the entry and eligibility requirements for benefits of the public and private sectors of Brazilian social security are presented below.

Structure and Dimensions of the System

Brazilian social security institutions are grouped into two major categories: public social security - henceforth referred to as the Brazilian social security system - and the private sector-henceforth referred to as private complementary pension funds.

Affiliation to the is mandatory for all salaried employees and optional for self-employed workers. It consists of two types of regimes:

a) The *General Social Security Regime*, encompassing all urban and rural employees in the private sector and in state enterprises and is managed by the National Institute for Social Security (INSS-*Instituto Nacional do Seguro Social*);

b) The *Special Pension Regimes for Civil Servants*, designed for central government employees (referred to as federal civil servants) serving in the executive, legislative and judicial branches. The other two levels of government-states and municipalities-have their own differentiated social security regimes, not subject to INSS norms and management.

Until very recently, these regimes differed widely, in terms of their own specific financial sources, rules and benefit plans.

The optional, voluntary private complementary pension funds also encompass two main forms:

a) "Closed" Private Pension Funds (*EFPP-Entidades Fechadas de Previdência Privada*) designed for employees in an enterprise, or group of enterprises, with a minimum voluntary affiliation of 50 percent of the employees required in order to function. Their objective is to complement the public entitlement scheme of the general social security Regime by paying beneficiaries, as a rule, the difference between the INSS pension and the last salary earned in their occupation in the firm.

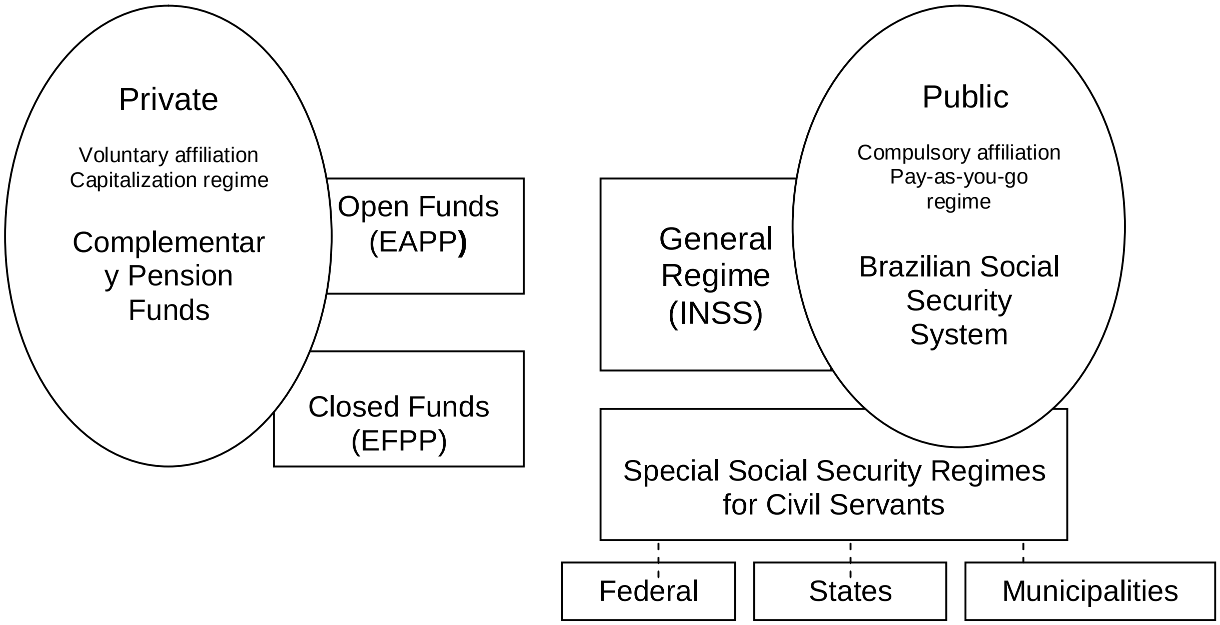
b) "Open" Private Pension Funds (*EAPP-Entidades Abertas de Previdência Privada*), designed for employees who wish to receive supplementary monetary benefits beyond those to which they are entitled upon retirement. The amount of those supplementary benefits varies according to the rules of the chosen benefit plan and are not related to the retirement benefits of the INSS.

The mandatory affiliation regimes follow a *pay-as-you-go* principle, while private pension funds operate according to a *capitalization* scheme.

Figure 1 summarizes the aforementioned structure

Figure 1

THE SOCIAL SECURITY SYSTEM STRUCTURE IN BRAZIL



The vast size of the Brazilian social security partially reflects the country's demographics and level of economic development, although one of its characteristics is its relatively limited coverage of the economically active population (EAP), as shown by the most significant indicators.

In 1997, the public social security sector (INSS, federal, state and municipal civil service regimes) covered 32 million contributors and close to 20 million beneficiaries. In 1998, expenditures within this sector reached 10,5 percent of GDP and represented approximately half of total governmental social expenditures. Table 1 presents the dimensions of the public sector.

TABLE 1
BRAZIL: DIMENSIONS OF THE SOCIAL SECURITY SYSTEM - PUBLIC SECTOR

Dimensions	Gen. Reg. (A)	Reg Civil Servants (B)			Total A+B
		Fed. (I)	State/Mun (II)	Total I + II	
Contributors-1996 (in 1,000 persons)	28,278	953	2,837	3,790	32,068)
Beneficiaries- 1996 (in 1,000 persons)	16,912	892	2,000	2,892	19,804
Revenues- 1998 (in US$ 1,000)	38,347	2,197	3,351	5,548	43,894
Expenditures-1998 (em US$ 1,000)	44,859	17,481	16,796	34,276	79,135
Expenditures as percent of the GDP (1998)	5.95	2.32	2.23	4.54	10.49

Sources: Ministry of Social Security and Assistance (MPAS) and Brazilian Institute of Geography and Statistics (IBGE)

Complementary private sector dimensions are quite modest, comparing to the public one. There are 1.8 and 2.5 million contributors US$ 65 billions and 4.8 billions in assets (with 3.6 and 0.8 billion of revenues) in EFPP and EAPP, respectively for the year of 1998. The number of beneficiaries represent 250,000 with US$ 2.4 billion in expenditures for EFPP in the same year (EAPP has no data for these figures). EFPP beneficiaries in 1997 amounted to 10.7 percent of the total number of beneficiaries of INSS, while its contributors represented only 6.8 percent of all those insured. There are no reliable figures for the EAPP.

Eligibility and Contribution Rules in Public Schemes

Following the logic of the pay-as-you-go model, the General regime is based on highly differentiated rules which define contributions and the scope and amount of benefits. Contribution rules in the General regime vary according to the occupational sector in which the insured workers are employed, as shown in Table 2.

TABLE 2
BRAZIL: CONTRIBUTIONS TO THE GENERAL SOCIAL SECURITY REGIME

Employees	Insured Contribution rates (%)	Employer Contribution rates and base (%)	Government
Urban	8 to 11% (20% self employed)	22% of total payroll	Covers eventual financial deficits
Rural	Exempt	2,5% of sale of results of first harvest	

Source: MPAS.

The ceiling of employee contributions is about 10 times the minimum wage (approximately US$ 69 in October 1999), as is the ceiling of pension values. In the case of urban employees, two other contributions, COFINS (Contribuição para o Financiamento da Seguridade Social, based on revenues) and the Net Profit Contribution-respectively based on 2 percent of an enterprise's total revenue and 10 percent of its net profits-are also earmarked for social security-theoretically for health-care and assistance benefits.
Finally, it is important to emphasize the important role of the state as a source of financial funds. Although the specific proportion of its participation in the structure of contributions is not predetermined, the state covers the public system's administrative costs (including staff), pays retirement pensions of federal civil servants, and complements general system resources to cover operational deficits.

The contribution rules of the special regimes for civil servants vary significantly among the three levels of government, especially with respect to contribution rates. The contribution of federal civil servants approaches that of normal contributors in the general system (increasing progressively from 8 percent to 12 percent, according income). As in the case of the federal government, state and municipal governments also cover deficits resulting from differences between collected contributions and expenditures with benefit payments.

Since the 1988 Constitution, the general regime sets a floor which is equal to the minimum wage and a ceiling of ten times the minimum wage for pension values. These amounts may be adjusted by a legally established index, which accompanies the adjustments of the minimum wage. On the other hand, until the 1998 social security reform, civil servants' benefits under the special regimes were not subject to the ceiling established in the general regime. According to the Constitution, civil servants' pension values should equal the last full active salary before retirement, and should be adjusted at the same time and by the same amount as their active counterparts.

Social security legislation was always permissive with regards to the reinsertion of retired employees in the labor market and cumulative pensions. In fact, after retirement, beneficiaries may continue to hold active employment in the labor market without any legal restrictions. Greater restrictions have been placed on civil servants since the 1998 reform.

The general regime's plan includes more than 60 different types of benefits, mainly covering old-age (retirement), disability (disability pensions), death (survivors' pensions) and work-injuries. It also includes temporary benefits for sickness, maternity leave, family-related benefits (family salary and family aid), and a large number of less important welfare payments. Unemployment insurance is not included in this plan. It was only introduced in the Constitution of 1988 and is funded by resources from the Worker's Aid Fund (FAT-Fundo de Amparo ao Trabalhador).

Until 1971, rural workers were not included in any social security regime. Since that year, and until the promulgation of the 1988 Constitution, they enjoyed very limited coverage, consisting of only 6 social assistance benefits. They became fully covered by the system in the 1990's, and are exempt from contributions.

Rules and types of pensions. Until the 1998 reform, the *general regime* covered various types of pensions: disability, old-age (65 years), length of employment (35 years), proportional (to length of employment with 30 years) and others of a special nature (from 15 to 30 years). It also includes a special pension-a Lifetime Monthly Income-designed for the destitute elderly and disabled people who were not eligible for normal retirement and pension benefits. The benefit payment is calculated from the average of the last 36 months of contribution, adjusted for inflation. Women may retire five years earlier in all those circumstances.

Civil servants enjoy the same types of pensions, except:

- they retire with their last full salary;

- increases and adjustments of benefits are indexed by the same proportions and at the same time as active civil servants' salaries.

Private Complementary Pension Funds

The legislation regulating the private sector of Brazilian social security covers two types of funds: open and closed. The former are managed by private institutions, such as banks, insurance companies or non-profit agencies, referred to as open private social insurance entities (EAPP), and are available to all interested persons. Benefits provided are practically the same as those of the social security system's general regime. Their plans may be organized on the basis of benefits or specific contributions. A periodic actuarial evaluation must be carried out in the case of benefit-base plans in order to guarantee adequate financial balances.

Closed pension funds, on the other hand, are not accessible to all. Managed by closed private social insurance entities (EFPP), they are constituted by and provide coverage to employees in a specific enterprise or group of enterprises. In contrast to open funds, employers may share the costs of the plan, whether related to administrative expenses or in the contribution base itself. Benefits tend to be identical to those in other sectors of the social security system, but they are based on contracts.

At the regulatory level, different agencies exercise control over different sectors. In the case of closed funds, the Complementary Social Security Department of the Ministry of Social Security and Social Assistance (*SPC/MPAS- Secretaria da Previdência Complementar/Ministério da Previdência e Assistência Social*) approves benefit plans and supervises the actuarial operation of the closed funds. Open funds are supervised by the Ministry of the Treasury's Department of Private Insurance (*SUSEP/MF- Superintendência* *de Seguros Privados/Ministério da Fazenda*). These agencies are also informed of the composition of investments and the financial situation of each fund.

The regulation of investments is probably one of the most important aspects of private complementary social security. According to public policymakers, the lack of maturity and modest dimensions of capital markets require special care to avoid manipulation, which would harm small stockholders, or misappropriation of funds which would negatively affect the financial interests of the insured. To prevent those problems, legislation regulating EFPP's and EAPP's determined that Brazil's Central Bank would establish, through resolutions approved by the National Monetary Council (*CMN-Conselho Monetário Nacional*), the minimum and maximum limits in the composition of the funds' portfolios, while the Securities and Exchange Commission (*CVM-Comissão de Valores Mobiliários*) would supervise the operations, so as to avoid disloyal practices, such as market manipulation.

Since the constitution of the Private Complementary Pension System in 1977, EFPP's (hereafter labeled "pension funds") have became more extensive than EAPP's.

According to the Ministry of Social Security and Assistance, EFPP assets (US$ 77,821 billion) represented 10.1 percent of GDP in December 1998, while EAPP assets only represented 0,9 percent (US$ 6,898 billion), for a combined total of 11.1 percent of GDP. There are a number of obstacles to market extension including:

- low wages and incomes in Brazil;
- rudimentary enterprise structures which resent difficulties in organizing pension funds or in negotiating complementary benefits with other enterprises, and
- costly benefit plans that cannot be financed exclusively by employees.

Since the 1980's, EAPP's have been of secondary importance in comparison with EFPP's. While the latter hold 90 percent of the private pension market, the former has never surpassed 10 percent and has maintained this share for the past 15 years.

Information on EAPP's is rather scarce. Nothing is known about the portfolio distribution of their assets, the types of plans each one adopts (defined benefits or contributions), number of affiliates, the geographic location of the entities, the value and types of benefits paid or the population covered. There are three types of EAPP:

- *insurance companies* held 73.4 percent of existing market assets. A significant number of insurance companies in Brazil belong to enterprise groups, led by commercial banks, including investment banks, and leasing companies.
- profit-oriented enterprises, specifically constituted for that purpose, accounted for 13.4 percent of the market.
- non-profit entities specifically constituted for the purpose of creating private pension funds hold 13.2 percent of the market

EFPP's may also be classified according to the role played by employers in their constitution and management. In order to identify the main features of each segment, it is important to observe the profile of sponsoring enterprises in terms of sources of capital.

In Table 3, EFPP's are classified as public or private. Public EFPP's have more assets and a larger number of benefits. This occurs because they have existed for a longer period than EFPP's of private enterprises. Other EFPP's are more numerous and have wider coverage. The growth of EFPP's of private enterprises points to their leading market position, in the future, in relation to EFPP's of public enterprises.

TABLE 3

BRAZIL: PRIVATE CLOSED PENSION FUNDS - GENERAL INDICATORS

General Indicators	Public		Private	
	Number/Values	**Percent**	**Number/Values**	**Percent**
Number of EFPP's	95	26,99	257	73,01
Total assets (US$ dec.98))	54,088,484,041	69,50	23,732,627,974	30,50
Insured population	3.199.929	49,93	3.208.444	50,07
Beneficiaries	292.503	58,30	209.238	41,70

Source: Secretaria de Previdência Complementar (1999)

In spite of the unstable performance of the Brazilian economy, EFPP's have presented high average rates of return, which are noticeably higher than GDP rates (10,0 percent in average from 1987 until 1996).

Nevertheless, EFPP's vary in performance, with public ones considerably better than private ones. According to recent data (World Bank, 1995:86), real average rates of return of public EFPP's were 14.5 percent per year between 1986 and 1992, against 12,2 percent for those in the private sector.

In recent years, the actuarial situation of the funds has not been as healthy, given the deficit shown in December 1998. EFPP's sponsored by public enterprises revealed an aggregate deficit of 6.4 percent of the total of mathematically constituted reserves, while private sector EFPP's revealed deficits of 0.2 percent. The comparatively better situation of private sector funds is probably due to the greater presence of mixed contribution plans, whose contractual reposition rates are lower than those of rigorously defined benefit plans.

To a large extent, actuarial problems arise from two factors:

- insufficient contributions to cover the obligations with affiliates already in the enterprise, but who had claims to integral salary complements promised by the enterprises at the inception of the plans, even if contributions fell short of what was necessary (the enterprises would contribute for them throughout the years until time of retirement), and
- generous benefit plans, with high reposition and early retirement (age 55 or less, in the case of insured who affiliated before the Law 6,435 of 1977 was promulgated).

THE CRISIS OF THE SOCIAL SECURITY SYSTEM: CURRENT DIAGNOSES

Endogenous and exogenous factors may be identified as components of the crisis of social security in Brazil. Among the former are historical financial and funding difficulties, the high costs of benefit plans and the administrative problems. Exogenous factors include demographic trends, economic circumstances and labor-market related problems. Because they affect the social security system's performance in decisive ways, exogenous factors are part of actuarial projections necessary for long-range management.

Each of the components will be briefly considered above in order to show the critical features of the system.

The Problems of Social Security Finances in Brazil

Although various factors contribute to the crisis - specially the low coverage of the system and the inequalities in pension values -, the financial dimension is undeniable, since resources captured have been insufficient to cover benefit obligations. The resulting deficit is high and recent reforms have not led to its elimination, although they have been able to reduce its size, as suggested by Table 4.

TABLE 4

SOCIAL SECURITY FINANCIAL BALANCES. GENERAL AND SPECIAL REGIMES FOR CIVIL SERVANTS, BY LEVEL OF GOVERNMENT

(US$ Millions, December 1998)

Types	1997	1998	1999 *
I. General Regime	(2,329)	(6,512)	(9,089)
II. Civil Servants' Special Regimes	(26,702)	(28,728)	(32,345)
Federal	(14,268)	(15,284)	(18,471)
States	(10,491)	(11,344)	(11,699)
Municipalities	(1,943)	(2,101)	(2,174)
Total	(29,031)	(35,241)	(41,433)

Source: Secretaria de Acompanhamento Econômico

* Projection

In addition to the growing deficit, Table 4 also shows the significant financed imbalances of civil servants' regimes. In a period of strong fiscal adjustments, social security reform has become a strategic issue in the public agenda and in the government's reformist program.

With respect to resources, current diagnoses of the financial structure of social security have emphasized the excessive weight of contributions on enterprises' payrolls, even though many benefits are not related to that basis. This has resulted in high contribution rates, which may reach 29 percent to 34 percent of payroll costs (adding both the urban employees' and employers' share of the contributions in the General regime). Many analysts argue that this is a factor which inhibits the competitiveness of Brazilian products in foreign markets. It is also considered unjust, since a very small segment of the population bears the burden for a system which is designed to benefit all citizens.

Proposals for a reduction of contribution rates have been frequently presented, especially by business groups, under the argument that it would both increase competitiveness and encourage an increase in the number of contributors. In fact, another critical factor influencing the system is the limited base of contributors, since only 43.1 percent of the employed population, or 40.5 percent of the economically active population are insured.

The 1988 Constitution diversified the financial sources for social security to include contributions from gross revenues, financial transactions and net profit. However, contributions based on the first two sources affect several stages of production of a particular product and increase the tax burden on many products, including those for export. In consequence, this form of financing penalizes the competitiveness of Brazilian products in foreign markets, worsening the balance of payments deficit and aggravating economic problems, as many critics of the current tax system have pointed out. The tax burden also encourages evasion and concealment, even beyond the unacceptably high current levels. In 1992, evasion rates were estimated as 76 percent of total contributions based on gross revenues and 98 percent of potential net profits (Beltrão, Oliveira, Lustosa and Marsillac, 1993).

Thus, besides unfairly burdening a small segment of society, which is responsible for financing a universal system of benefits, the new sources for financing social security also proved to be inefficient and unproductive as a basis of tax contributions, unjustifiably combining contributive and distributive principles.

But economic factors should not be overlooked in the analysis of the system's performance. The recent economic context of monetary stability, fiscal adjustment, increasing unemployment and open imports has negatively affected the social security system. Until the mid-1970's, economic growth and high rates of employment benefited the system's early stages by allowing for a high contributor/beneficiary ratio. In the 1990's, however, the realignment of pension payments and enforcement of constitutional measures, was accompanied by modest rates of economic growth, a reduction of formal employment rates and increases in unemployment. This has highlighted and reinforced the fragile and dire situation of the Brazilian social security system.

The High Costs of Benefit Plans in Brazilian Social Security

Due to the absence of minimum-age requirements in entitlement rules-as in the case of the length-of-employment pensions-and high replacement rates of active salaries, which for some insured categories may reach 100 percent of last active salaries, most analysts consider Brazilian pension benefits as generous. Retired employees may continue in the labor market and accumulate pension benefits and, of the total number of beneficiaries with length of employment pensions in 1995, 32 percent were age 49 or less at the moment of retirement and 67 percent were age 54 or less.

The available information shows that persons retiring under length-of-employment or other special pensions have higher life expectancy upon retirement than those retiring due to old age. By the other hand, although they are only 37 percent of the total volume of pensions, the special and length-of-employment persons represent 61 percent of the expenditures. In spite of resistance from some sectors, the introduction of minimum-age requirements and the elimination of length-of-employment pensions were almost consensual in recent reform proposals.

Management problems of Brazilian Social Security

In 1998, the administration of the Brazilian social security system accounted for 7.9 percent of the total spending with benefits. Many observers consider this to be unacceptable. In addition, in spite of improvements-since the average time for processing retirement applications has decreased from 160 to 22 days since 1992-the quality of services remains inadequate. Tax evasion and concealment is still high, representing nearly 22 percent of the total value of potential contributions in 1996 (excluding those who do not contribute). The proportion of canceled benefits as a result of auditing procedures is currently 3.2 percent of the total number of benefits, but reached 14.3 percent in 1993 when special auditing was carried out in order to combat frauds. These frauds or inefficiencies occur during medical exams or in the bureaucratic processing of pension applications.

Finally, the system has not been completely computerized and a registry of contributors has only been available since 1997, which only recently made possible greater prevention of fictitious estimates of length of employment which could occur previously, for example, through false statements from employers or fellow employees.

Social Security and Brazilian Demography

These financial imbalances have also been exacerbated by recent demographic trends. Alongside the increase in the proportion of the population aged 60 or more, life expectancy at birth continues to climb-along with life expectancy after retirement, which directly impacts social security. Between 1980 and 1997 the number of active contributor for each beneficiary fell from 3.2 to 2.1. This is similar to dependency ratios in countries with older age structures, such as Japan, the United States of America, France and Germany. Projections indicate this ratio may reach 1.2 or less by 2020, unless formal employment rates increase or benefit entitlement rules do not change rapidly (Além and Giambiagi, 1997).

Labor Market and Brazilian Social Security: A Brief Analysis

Labor market factors merit a specific analysis. Although the current dependency ratio is 2.1 contributors per beneficiary, this would change to 6.77 if the entire employed population contributed (based on 1997 data). Slower economic, growing unemployment and a decrease in formal employment have reduced the pool of contributors to the system. The economic recovery which began in 1993 did not increase formal employment (in terms of number of contributors in the social security system). While wages represented 36.39 percent of the functional distribution of income in 1990, they fell to 28.82 percent in 1997. Informal employment did not absorb the difference, as its participation varied between 6.92 percent and 5.68 percent during this period.

Eight out of ten jobs created were in the informal labor market, according to Baltar (1998), reflecting the increasingly fragile labor structure in Brazil. Unemployment reached 8.15 percent by March 1999. The economic crisis, the obstacles to reforming the state apparatus and its control instruments and the competitive barriers in the world market have aggravated the situation. It is impossible to anticipate exactly which will be the short and long-term results of these trends. However, under current eligibility rules, they may create insurmountable actuarial problems if solutions are not found soon, as it may reinforce the social exclusion which has been a permanent feature of Brazilian society.

THE MAIN PROPOSALS FOR REFORM

A range of proposals have been developed to address the crisis of the Brazilian social security system.

Proposals to Restructure Benefit Plans

For analysts more closely identified with private-sector interests, as well as for many who defend the public nature of the system, benefits should be planned according to more rigorous actuarial criteria. In the area of retirement pensions, the elimination of length-of-employment criteria and the need for a minimum-age requirement-generally proposed to be set in the 60-65 age-range-is considered as a central component of the system's future viability.

There is greater consensus regarding a minimum contribution period-between 15 and 20 years-for entitlement to an old-age pension. Opinions differ with respect to the permanence of rural and welfare benefits in the social security system, even though there is agreement regarding their funding with taxation. There is also general agreement that women should have a shorter contribution period than men-usually 5 years less-although some recent proposals defend equal periods. Work-injury benefits are seen as a function of the degree of supervision of working conditions, which should be strengthened. Although most analysts consider contribution rates high in comparison to other countries, very few propose their reduction or limiting the base to employees' salaries, exempting employers from any responsibility, as is the case in Chile since 1991. The financial frailty of the Brazilian social security system would require public financial support for a long period. Only a few defenders of private interests consider this to be a feasible alternative.

Those who defend workers' interests consider that high employers' contributions are necessary in view of low wage levels. As argued also by analysts linked to the public sector, given the state's feeble controls, reduced employers' rates would mean lower tax revenues, without effectively generating formal employment.

Proposals to Restructure Finances

Among the most important proposals being debated, those related to the restructuring of social security finances are not very consensual. Although there is general agreement that current contribution rates are unsustainable, few observers support proposals to abolish employer contributions. Only a few advocates of private-sector interests consider it a viable alternative. Advocates of employees' interests hold that high employer contribution rates are a result of low wages. In their view, also embraced by public-sector analysts, rate reductions would result in loss of revenues-due to the deficiencies of fiscal control by the state-and would not increase the level of formal employment.

Proposals to Restructure the Institutions of Brazilian Social Security

The strongest proposals for change focus on the legal-administrative aspects of social security provision. Both, public and private sector interest groups believe that a reduction of the ceiling of general regime benefits and the transfer of special civil servants' regimes to that regime would reduce disparities in terms of benefits, while at the same time making room for private complementary pension funds, under the individual capitalization regime. Most of these proposals defend a regime of defined contributions and the predominance of the private sector in social security. Within this model, the social security regime would rest on two pillars: compulsory adherence to the general social security regime and optional affiliation to private complementary insurance.

The discussion regarding the transition from the current to a future regime has occupied a significant part of the debates. Among the alternatives discussed, one posits pecuniary incentives to the lower-income (less than ten times the minimum wage) insured, through stocks equivalent to the total amount of past contributions, which would receive actuarially estimated interest rates, and transferred to the new complementary fund. The insured could also remain in the previous regime, as long as they paid actuarial costs. This mechanism would imply a significant increase in tax deductions on salaries for insurance expenses.

The state would regulate and exercise fiscal control over those funds, as well as participate directly, in many cases, through benefit plans created by state banks. These banks would compete with the private sector and receive tax exemptions similar to those already in effect. Such measures would be accompanied by a gradual elimination of the fraud and management problems present in the INSS, as was previously described.

Although advocates of employees' interests do not agree with proposals to lower ceilings in benefits and contributions, they tend to accept uniform rules for all systems, which would allow for the introduction of complementary benefits for those insured under the civil servants schemes.

The Probable Costs of Proposed Reforms of the Brazilian Social Security System

Several prospective studies have been made to predict the future of Brazilian social security. Recent simulations by the Ministry of Social Security project three scenarios, based on certain assumptions: minimum-age requirements, lower minimum pension benefits (from 1 to 0.5 minimum wages); elimination of shorter contribution periods for women and rural workers and lower ceilings for contributions/benefits (do not include eliminating employers' contribution rates nor changes in the current salary-replacement rates). Several exogenous variables are also introduced in the model, such as changes in GDP, gross revenues, undistributed profits, per capita income and average minimum wages.

The best scenario results from a private-sector adjustment, emphasizing the privatization of the enterprises and services provided by the state, as all the variables in the model reveal increases (Scenario 1 with an annual GDP growth of 4 percent and an average salary growth of 3.5 percent). On the other hand, the public-readjustment alternative, with public sector predominance, under the assumption of state success in resolving financial problems, through higher tax revenues and deficit reduction, reveals lower increases (Scenario 2, with an annual GDP growth of 4.5 percent and an average salary growth of 4.1 percent). Finally, the third alternative portrays a crisis scenario of the social security system, without GDP growth and low or negative variation in the other variables (Scenario 3 with an annual GDP growth of 0 percent and an average salary growth of 2.1 percent).

The introduction of a minimum-age requirement, ranging from age 60 to 65, similar to those observed in most OECD countries, would considerably reduce the potential deficit. If such a change were accompanied by the elimination of gender differences in that requirement, expenditure reduction would be even more pronounced. Only a significant reduction in benefit ceilings would result in substantial deficit reduction: not even a reduction from 10 to 3 times the minimum wage would have perceptible effects on the deficit, specially in view of the risks of individual capitalization schemes. In the short-run, until 2005, such changes would even tend to aggravate public finances. Only in 2030 would benefit reductions show a limited favorable impact on the financial balance. The major differences seem to occur in a crisis scenario. In the case of market-oriented readjustment, the maintenance of a ceiling ten times the minimum wage would lead to best results, as is the case with public-sector readjustment. Finally, a reduction in benefit ceilings to 0.5 minimum wages has a positive impact on public social security finances under all of the scenarios considered: reduction in expenditures would be 1 percent (scenarios 1 and 3) to 2.2 percent of GDP (scenario 2) by the year 2030. Table 5 shows these impacts in the three scenarios considered:

TABLE 5
THE BRAZILIAN SOCIAL SECURITY SYSTEM: FINANCIAL NEEDS IN 2005 AND 2030
Under Different Ceilings and Scenarios (Percent of GDP)

Scenarios in 2005 and 2030		**Without minimum age (present situation)**			**Ages 60 (women) and 65 (men)**			**Age 65 (both women and men)**		
		3 minimum wages	5 minimum wages	10 minimum wages	3 minimum wages	5 minimum wages	10 minimum wages	3 minimum wages	5 minimum wages	10 minimum wages
1	2005	1.04	1.36	1.06	0.56	0.56	0.23	0.46	0.45	0.12
	2030	5.05	6.46	6.21	2.70	3.30	2.96	2.25	2.08	2.44
2	2005	0.77	1.19	0.80	0.43	0.37	+0.04	0.31	0.24	+0.18
	2030	5.30	6.63	6.27	2.86	3.38	2.93	2.30	2.77	2.30
3	2005	1.62	1.98	1.58	0.81	0.83	0.40	0.67	0.68	0.24
	2030	7.43	9.59	9.25	3.95	4.88	4.43	3.33	4.18	3.71

Source: Oliveira, Beltrão and Marsillac (1996).

THE REFORM OF 1998 AND THE NEW PERSPECTIVES FOR THE BRAZILIAN SOCIAL SECURITY SYSTEM

After a long period of discussion and as a result of four years of intense parliamentary debates, the reform of Brazilian social security was approved at the end of 1998, opening the way for new perspectives and future scenarios.

The Recent Social Security Reform in Brazil

The reform of the Brazilian social security system gathered pace in April 1995, during the Fernando Henrique Cardoso administration. Emphasis was placed on amending the constitutional nature of many of the social security principles and on improving the balance between contributions and benefits.

Diagnoses and discussions pointed out that, under existing conditions, the insured with low wages were bearing the financial burden of those with higher incomes, an unjust situation creating system imbalances. The main objectives in the government's reform drive were to increase the contributive base and period and reduce the value and length of benefits.

The parliamentary proceedings on the government's reform project, between 1995 and 1998, were long and arduous, but a partial reform of the system was finally approved. Among the most important changes introduced were:

Changes to the Benefits:

- the length-of-employment pension abolished,
- proportional pensions (granted five years before stipulated years of employment with a 30 percent reduction in the value of full pension benefits) abolished, and
- special pension for certain occupational categories, (except those for elementary and secondary school teachers and for workers in unsanitary occupations) abolished.

Changes to Eligibility Criteria:

- minimum-age requirement of 60, for men, and 55, for women, to civil servants,
- minimum period of public employment of 10 years and 5 years in the same job in order to receive full pension benefits, and
- cumulative pensions, except for physicians and teachers prohibited.

Changes to Special Regimes and Social Assistance Benefits:

- different special civil servants' regimes in the three levels of government merged and state and municipal governments prohibited from creating their own regimes, and
- Social assistance benefits under the general regime's benefit plans suppressed (such as birth assistance; funerary assistance and lifetime monthly income).

Changes to private complementary pension funds:

- public sector sponsors of EFPP prohibited from absorbing expenditures above 50 percent of total contributions, and
- benefit plans of EFPP's required to permit portability of insured and their funds among different types of private insurance institutions, as well as anticipated withdrawals.

A certain consensus exists that the reform was incomplete. Although the measures have significant effects on public finances (that is, deficit reduction), the government considers them insufficient to overcome the financial problems in the public sector. Partly as a result of these limitations, further revisions were undertaken immediately after approval of the reform, including increasing contribution rates of higher-income insured and introduction of contribution rates of higher-income beneficiaries. The estimated financial impact of both sets of measures-those included in the reform and those adopted in later revisions, through normal legislation-are shown in Table 6.

TABLE 6

ESTIMATED IMPACTS OF 1998 SOCIAL SECURITY REFORM AND FISCAL ADJUSTMENTS
(In US$ Millions of December 1998 and Percent of GDP)

Results	1999		2000		2001	
	US$	%GDP	US$	%GDP	US$	%GDP
General results of structural and temporary reforms	4,659	0.61	8.588	1.08	11,080	1.31
Social Security Reform - Structural	2,528	0.33	4,998	0.63	7,382	0.87
Fiscal Adjustment - Civil Servants Temporary	2,131	0.28	3,590	0.45	3,698	0.44

Source: Secretaria de Acompanhamento Econômico (1999)

Although important, the corrective medium-term effects of the reforms are modest and tend to reintroduce discussions and public debate regarding a new wave of changes in the social security system.

New Perspectives for Social Security Reform in Brazil

To a certain extent, the limited reforms reflect ill-conceived political strategies, whether from the government or from the groups opposing reform.

The government's strategy actually presented social security reform as a gradual process, or at least it was resigned to this gradualism. In Brazil, as in other countries undertaking social security reforms within a democratic context, this process mobilizes the entire society, all interest groups, and, therefore, tends to be characterized by protracted, conflict-laden negotiations.

Nevertheless, in the Brazilian case, the process that transpired between 1995 and 1998 was off-track, sluggish and mishandled by the federal executive branch. This highlighted by the absence of a coherent explanation of the general importance of the set of measures or of the resulting profile of the social security system underlying them. Finally, improved benefits were not even promised.

In fact, the government's strategy in presenting its proposal adopted a low profile and each measure was defended separately, in a fragmented manner, rather than as part of a totality. Although this strategy had some advantages, as it allowed for separate negotiations regarding each measure or groups of measures, the disadvantages were significant, including the loss of coherence and the assurance that they would result in sustained system balance.

Due to their ambiguous stance in relation to delicate and difficult issues, the political actors opposing reform were disappointing, as they vetoed morally and socially corrective measures and supported socially regressive and unjust positions. Consequently, the opposition lost a valuable opportunity to separate the issues which the reformists had strategically combined: control of the public deficit, generated by other and more important factors, besides social security and the importance of social security reform itself, both because of the need for its long-term financial balance and of the distortions and inequities which it contains.

The ensuing political vulnerability may be disastrous, as new rounds of social security reforms are being announced. By April 1999, the government had sent to Congress a new legislative proposal with several measures: the creation of individual social security accounts, with appended 3 percent actuarial, annual interest rates, to form the basis for personal insurance, and a gradual increase in the number of months for calculating average benefit payments, initially increasing from 36 to 120 months. According to the social security officials, the general regime would, therefore, move from the present distributive system to one of individual accounts, and, finally, to the full-capitalization regime. Funds would be constituted by the collection of amounts owed to INSS and by cumulative future revenues, including the government's active debt. The current system would be maintained up to a ceiling of US$ 1,002. Nevertheless, resources would continue to be directed to cover benefit expenditures, without the creation of reserves. Such procedure is necessary, since Brazil could not support the high costs of transition from a simple distributive regime with defined benefits to one of individual capitalization, with immediately defined contributions, without a transition period of several years.

Since many insured retired before reaching age 55, it is expected that values will fall under a system with individual accounts and defined contributions. This would open the way for a greater presence of a private complementary pension system, since the difference between the benefit provided by the social security system and the active salary would be much larger than it is today. Although current proposals do not guarantee the immediate constitution of a more significant capitalized insurance system, as in neighboring countries, they would open the way for those initiatives in the future. The central problem of such proposals is the abrupt imposition of real losses on a more complex society.

Perspectives of the Dimension of the Private Complementary Insurance Market

Projections of the accumulation of assets of private complementary pension funds in Brazil have not been very successful. Besides the problems normally involved in projections of that nature, these also involve expectations regarding the future structure of the Brazilian social security system and the spaces allowed for those private institutions. Obstacles to reform increase the uncertainties in estimating the size of the future market.

An example of these difficulties may be observed in the forecast by ABRAPP-Brazilian Association of Closed Pension Funds (Associação Brasileira de Entidades Fechadas de Previdência Privada) that its participation in the social insurance market would increase to 18 percent of GDP by the year 2000, from 11.02 percent today. It is difficult to imagine a 6.92 percent increase in a single year. This estimate does not result from a technical mistake, but rather from the expected decrease in public-sector participation in social security, after the ongoing reforms, and the subsequent market entry of a large number of private insurance firms. The uncertainty and delay in carrying out the reform were the main reasons for this "error".

More recent projections which take into account recent social security reforms indicates significant assets growth of the private complementary insurance institutions. Brazil continues to hold the largest volume of these assets, although its participation in the GDP is more modest than in Latin American countries which privatized their systems.

The segment will continue, therefore, to be important in the Brazilian and Latin American context, although projections show a reduction in the participation of private financial assets from the current 60 percent to 46.7 percent in the year 2015.

FINAL OBSERVATIONS: SOME LESSONS FROM THE RECENT BRAZILIAN EXPERIENCE

The three main tendencies observed in the recent movement towards social security reform in Brazil have been: the search for financial balance; exclusive or enlarged participation of the private sector in the complementary pension market; the development of a new regulatory framework. As this paper has attempted to demonstrate, both the majority of proposals and the recently approved reform measures are of the benefit-provision demonopolization type, directed towards a partially competitive social security market. In that sense, the Brazilian case is similar to those of its Latin American neighbors, as it follows the general tendencies of institutional reforms observed in the region.

However, the Brazilian system holds several specificities which separates it from its neighbors.

Although his social security system has been experienced growing financial difficulties and problems, it has fulfilled its financial obligations without going bankrupt. In consequence, many of the reform proposals would impose greater losses on the insured than those experienced in the past, due to inflation, or even at present, since the major problems have not manifested themselves through abrupt decreases in pension values or discontinued payments. Therefore, reform prospects tend to be perceived by the insured only as immediate losses and only beneficial in the long run. This lack of perception of system bankruptcy also reinforces opposition to the reformist project. However current expenditure projections show that the system will encounter, at least in the medium-term, serious problems. Under present conditions, just in the Federal Regime, the projected deficit in 2030 will vary between 6.21 percent and 9.25 percent of GDP, the equivalent of 20 percent to 30 percent of current tax revenues! Financial deficits of this magnitude could hardly be absorbed without a deterioration of social security services, especially in terms of real pension values. Besides the dire situation of the public deficit, retired employees are running high medium-term risks.

Recent changes and reforms have not yet been able to alter this negative scenario.

But it is similarly wrong to imagine that the privatization model by itself would correct these imbalances. Projections, based on the parameters of the radically privatizing Chilean model, indicate an immediate deficit increase in the system of 6.5 percent of GDP and a public sector deficit (measured as financing needs of the public sector) varying between 8 percent and 8.5 percent-imbalances which could hardly be met by public finances in Brazil.

The private sector of the system also has its peculiarities which seem to resist radical privatizing solutions similar to the Chilean model. In fact, besides its long history and dimensions, as it is surely the oldest and most powerful private social insurance sector in Latin America, in terms volume of financial assets, the private social insurance model in Brazil is closer to the United States model of pension funds than to Chilean AFP's, insofar as it is financed by both employers and employees, rather than only by individual employees with defined contributions and managed only by private institutions. This view is reinforced by the weak performance of EAPP's in comparison to EFPP predominance, as mentioned above, as a result of the prohibitive costs of funds without employer contributions.

Therefore, the perspective of a Chilean-style radical privatization does not seem promising. This is indicated by the recent regulatory project of civil servants' pension funds (federal, state and municipal) submitted to the National Congress in April 1999, which proposes an EFPP, rather than an EAPP, format.

However, it is undeniable that a more pronounced market orientation compatible with a public social security system, complementing and supplementing each other, may contribute to overcome the difficulties encountered by the latter. In fact, this is the point of view of most proposals and tendencies of public opinion. Among other conditions, this requires a growing private sector and measures that would make it compatible with the design and characteristics of the general regime.

The systemic factors restricting the attraction of private pension funds and, therefore, the broader market orientation of the system are not trivial. The high salary replacement rates in the general system and the full replacement of civil servants' salaries tend to reduce the "need" for complementary pensions, especially in the context of stability created by the Real Plan, since 1994.

Although it is true that current reforms raise the issue of complementary pensions in the perspectives of the insured and of future beneficiaries, the uncertainties and contradictory tendencies of the reformist process and its future prevent a fully stable regulation of this sector. This situation inhibits the entrance of new insured persons and institutions in the still stagnated private pension market.

It is important to mention that the paths and rhythms of the market orientation of the Brazilian social security system will probably express the solutions of the regulatory framework and, in general terms, of the reform of the state.

Many of the obstacles still inhibiting the accelerated development of the private social insurance sector today are of a regulatory nature. Inadequate system rules and distortions, such as the requirement of minimum levels of portfolio investments in stocks and public securities, are seen as factors which contribute to lower rates of return of funds and inhibit the action of private managers.

However, the limited capacity to control fraudulent funds, as occurred in the 1970's, and the sluggish recuperation of resulting losses through the courts, instill lack of confidence in potential affiliates and inhibit the growth of this sector.

Finally, the obstacles regarding vesting and portability also inhibit the extension of the private system to potential employees. The new bill of April 1999, dealing with the private pensions, treats portability in a more incisive manner. But the structure and nature of the future institution of re-insurance is still unclear, especially with respect to the protection of insured from possible inept and fraudulent management, as it exists in other countries.

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