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BRAZILIAN PENSION SYSTEM REFORM

*Meiriane Nunes Amaro
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1 - INTRODUCTION

The current discussion and evaluation process of a deep restructuring of the Brazilian Pension System was intensified almost five years ago, when the Government's proposal was formally presented to the society. Ever since, the new features of this System have been thoroughly discussed, with its growing financial unbalances as backdrop.

A retrospective of the legislative process of the proposal leads us to March 1995, when the Executive Power sent the initial Constitutional Amendment to the Congress. The following year, the bill approved by the Chamber of Deputies (July 1996), quite different from the original one, did not accomplish the primordial objective of guaranteeing actuarial and financial equilibrium of the Pension System in the long run.

In the Senate, however, that bill was again modified. As will be seen, the Constitutional Amendment bill approved by the Senate assumed an intermediate structure between the Government's bill and the one approved by the Chamber of Deputies. It maintained an extremely detailed text, but incorporated several important restrictions to the plans of benefits, especially in the public sector.

Considering the wide modifications undertaken in the Senate, the bill had to come back to the Chamber of Deputies in October 1997. It was approved in November 1998, although with important and unfavorable changes in points considered fundamental for the Government.

During that period, debates and discussions were intense, resulting in huge modifications in the bill finally approved by the Congress: Constitutional Amendment 20, 1998 - PEC 20/98.

The instability of the Brazilian economy in face of the adverse international panorama has made the control of public expenditures indispensable. This situation positioned the approval of the Pension System Reform as primordial and urgent in the context of the national agenda. This continues to happen in the legal regulation process now in course. Such regulation needs to be indeed satisfactory, in order to allow the opportunities opened by the Amendment to become a reality, assuring as a result the long term balance of the Brazilian Pension System.

This paper presents a general panorama of the Brazilian Pension System Reform, with prominence in main changes undertaken in the constitutional text as a result of PEC 20/98. In order to present a global overview of the undertaken modifications, the first part analyzes the most important changes between the original Constitutional Amendment bill and the one finally approved by the Congress. The next part subdivides the most important changes into three different areas: the retirement system of the public sector, major focus of the alterations; the public social insurance (private sector); and the pension funds system.

This panorama is complemented by the analysis of the recent, and continuing, process of legal regulation of the subject: bills presented by the Government in 1999 especially the one already transformed in law and other almost to be promulgated.

Some comments concerning the economic situation of Brazilian Pension System accounts are presented, as well as some conjectures about the main perspectives of the System in the long run.

Finally, some final comments conclude this analysis.

2 - GOVERNMENT GOALS AND CONGRESSIONAL BILLS

Initially, the central coordinate of the discussed proposals was to join the three existing pension systems, the general, the system of the public sector and the one of the Armed Forces, in only a single unified system with the following three pillars, the first two mandatory and the third voluntary:

- a) a minimum public pension with the upper limit equivalent to three minimum wages (about US\$ 230/month) and based in the "pay-as-you-go" system, where current expenditures are financed by current revenue;
- b) a complementary private pension, which could achieve the maximum of nine minimum wages (US\$ 680/month), based in funded pension plans (a scheme based in individual accounts and defined-contributions);
- c) additional coverage provided by private funded pension plans (already existent in Brazil).

Such conception was based on internal studies and analysis of important international institutions, which advised Brazil make a structural change in its Pension System. This change should be based in a multi-pillar system:

- a) a public basic pillar, based in the "pay-as-you-go" system, established to alleviate poverty and which the roof would be close to three minimum wages;
- b) a mandatory funded pillar, that would include workers whose incomes were between three and ten minimum wages;
- c) a voluntary pillar, also fund based, destined to cover workers with higher income (it represents the pension funds that already exist in Brazil).

This configuration should embrace all workers. Thus, this implicated the end of special pension systems.

However, during analysis and discussion process of the matter, the Government concluded that such a coordinate was not plausible. This conclusion was a result of political and economic considerations. In the first case, the problem was the great political resistance, mostly from civil servants and their powerful lobbies. In the second, the restriction was the extremely high cost of a transition between the old and the new systems in a context of serious financial restrictions of Brazilian public sector.

Therefore, in March 1995, constrained by the concrete perspective of growing budget deficits, the Government sent to the Congress a pragmatic Constitutional Amendment bill. It tried to achieve the most feasible way of approval: maintenance of the three different systems, with a huge equalization of rules among them and the imposition of many parametric adjustments. The Government relinquished the third pillar. Thus, the bill included only the current two-pillar system already existent: the mandatory public social insurance and the special

retirement systems of the public sector, in one side; and the voluntary private pension funds, in other.

Furthermore, the Government proposed the "desconstitucionalização" of the matter, represented by the elimination of a great part of issues related to the subject from the constitutional text and its transfer to law regulation that requires a smaller quorum for approval. This strategy looked for to facilitate future legal adaptations to fiscal needs. The elimination from constitutional text of pensions concession rules in the public social insurance represents an example of such "desconstitucionalização". This, as it will be analyzed, made a way for an important improvement achieved in legal regulation of the approved Amendment.

In general, the Government's proposition looked for, among other objectives, to accomplish a basic end: to eliminate important constraints to system equilibrium in the short and medium run and to assure the institution of a pension system actuarially consistent in the long run.

In this context, many restrictions were imposed in the scope of the retirement systems, for example:

- a) substitution of the length of service pension by other based in years of contribution and restricted by a minimum age;
- b) elimination of the proportional pension (pensions with less contribution period);
- c) prohibition of pensions accumulation;
- d) equalization of the rules applied to men and women, to urban and rural workers and to teachers and other professionals.

Other restrictions were applied only to civil servants, such as the establishment of mandatory social contributions of pensioners and the end of the linkage between changes in the wages of working civil servants and changes in pensions' values.

Pension funds sponsored by State owned companies were targeted too. It was required that the State owned companies' contributions were equal to those of employees, as well as it was required changes in these funds in order to guarantee their actuarial equilibrium.

Complementing these changes, the Government's Constitutional Amendment bill deregulated the work-related accident (or illness) insurance.

After the long legislative process followed in the Congress, many points of the Government's Amendment were not approved. The intention of "desconstitucionalização", for instance, did not succeeded. At the end, the Constitutional text related to the pension system, instead of being shortened, was enlarged.

Furthermore, the Amendment approved by the Congress, in December 1998, maintained the three different pension systems, only equalizing some rules between the public social insurance and the retirement system of civil servants. The Armed Forces pension system was not changed.

Nonetheless, many improvements were reached. The majority of them attempted to reduce, in the medium and the long run, Treasury expenses related to pensioners' payroll. Among the principal advances, it can be underlined the addition of the following parametric adjustments:

- a) at least ten years of service in the public sector and five years in the last public function, in order to be able to retire from this sector;
- b) the end of accumulation of pensions, as well as the end of income increase when civil servants are retired;
- c) constraints to accumulation of pension and wage and imposition of a maximum value to public pensions;
- d) minimum age required in order receiving the length of contribution benefit.

The possibility of establishment of pension funds by the Union, States and Municipal branches represents other fundamental innovation. The special and more favorable rules of the public sector will apply only to workers whose incomes are less than the maximum pensions paid by the public social insurance.

In addition, pensions with smaller periods of contributions (proportional pensions) and special pensions of university professors were also eliminated (restrictions applied to the private and the public sectors).

The work-related insurance was deregulated; that is, it was opened to private sector participation. Also general rules were established for pension funds in general. Related to pension funds sponsored by State owned companies and directly by the State, the following restrictions were determined:

- a) equivalence between contributions of State owned companies, or of State, and those of the employees; and
- b) obligation to proceed with many changes in pension funds, in order to guarantee their actuarial equilibrium.

It is important to stress that legal individual rights already acquired by participants of the retirement systems, when the Constitutional Amendment was approved, were preserved.

Finally, it is fundamental to emphasize that Constitutional Amendment 20/98 did not include the following fundamental adjustments:

- a) age limits for pensions paid by the public social insurance (private sector), considered by the Government the major measure in the system restructuring;
- b) contributions of pensioners;
- c) the reduction of future pensions granted by the public sector to civil servants with higher incomes, that could reach 30% in accordance to income level, with integral pension maintenance for civil servants who received less than the maximum pensions paid by the public social insurance.

3 – PARAMETRIC ADJUSTMENTS DUE TO THE PENSION SYSTEM REFORM

So far, it has been presented the principal differences between the Government's Constitutional Amendment bill and Amendment 20. Here will be analyzed the most important improvements achieved with the Constitution Reform.

These modifications are focused in three topics:

- major changes in the retirement system of the public sector;
- major changes in the public social insurance;
- issues linked to the pension funds system, especially changes in funds sponsored by State owned companies and directly by the State.

Each theme will focus on the principal differences between the rules effective in the 1988 Constitution and the new rules established by Amendment 20, presenting tables that synthesize the undertaken alterations, accompanied by pertinent comments.

3.1 – Major Changes in the Retirement System of the Public Sector

The majority of changes in the public sector were intended to diminish expenses, although they accomplished, in addition, the goal of approximating rules of the retirement system of the public sector and of the public social insurance.

The most relevant alterations are presented in tables followed by specific comments. They are about:

- the length of service pension;
- constraints to accumulation of pension and wage;
- definition and following monetary adjustments of pensions;
- incidence of social contributions upon pensioners' incomes;
- institution of pension funds for civil servants.

It is important to remind that the retirement system of the Armed Forces members did not change. Therefore, new rules here analyzed do not apply to them. Furthermore, after recent approval of the Constitutional Amendment 18, Armed Forces members are not considered civil servants anymore. Now they are militaries of the Union, States, DC or Territories.

Table 1 – Length of Service Pension

1988 CONSTITUTION	AMENDMENT APPROVED
<p><i>Civil Servants in General:</i></p> <ul style="list-style-type: none"> - <u>Integral</u>*: a) man: 35 years of service b) woman: 30 years 	<p><i>Civil Servants in General::</i></p> <ul style="list-style-type: none"> - <u>integral</u>*: a) man: 35 years of contributions and 60 years old b) woman: 30 years of contributions and 55 years old + 10 years of service in the public sector and 5 years in the last public function before retirement <p>* <u>transition rule:</u></p> <ul style="list-style-type: none"> - a plus in the contribution period equivalent to 20% of

1988 CONSTITUTION	AMENDMENT APPROVED
	the period of contribution that was lacking (in December 1998) to amount 35 years of contributions, if man, or 30, if woman - + 53 years old, if man, or 48, if woman - + 5 years in the last public function
– <u>proportional</u> : a) man: 30 years of service b) woman: 25 years	– <u>proportional</u> : eliminated * <u>transition rule</u> : - a plus in the contribution period equivalent to 40% of the period of contributions that was lacking (in December 1998) to amount 30 years of contributions, if man, or 25, if woman, - + 53 years old, if man, or 48, if woman - + 5 years in the last public function before retirement
Teachers: – <u>integral</u> : a) man: 30 years of service as a teacher b) woman: 25 years of service as a teacher	Teachers: – Maintenance of the especial benefit only for teachers in elementary, middle and high schools, but with minimum ages of 53 years, if man, or 48, if woman. * <u>Transition rule</u> : practically the same rule established for civil servants in general.
Members of the Court: – <u>Integral</u> : 30 years of service + 5 years in the public function as a member of the Court.	Members of the Court: – The same rules applied to civil servants in general.

* *Integral pension means 100% of the last wage.*

Initially, it fits to emphasize that old-age pensions, followed by pensions for death, are the most important benefits granted by any pension system.

Besides, the length of service pension - that only exists in Brazil, Ecuador, Iran and Iraq – has been, undoubtedly, the most targeted benefit in the Brazilian Pension System Reform. It occurs because it is by far the most expensive retirement program, a result of the combination of relatively short years of contribution, high period of benefit payment, high replacement rate and high average wage of its beneficiaries. The last factor happens because the length of service pension basically favors workers better located in the labor market, with formal and stable jobs that allow them to keep records of their length of service (or contributions).

The Pension System Reform did not extinguish this benefit, but restricted it, imposing limits of age and proof of length of contributions, instead of length of service, as well as eliminated the proportional pension (with shorter time of service).

All these adjustments imposed to the concession of the length of service pension contribute to reduce expenditures in the medium and long run. They impose the postponement of retirement

request, increasing the waiting period, at the same time that they reduce the length of years of benefit's payments.

The prerequisite of ten years of service in the public sector in order to be retired by the respective retirement system is another great adjustment. The restriction prohibits that people, who worked in the private sector for many years, and, consequently, contributed only to the public social insurance (where contribution's roof is limited to ten minimum wages), work in the public sector for a short period of time, being retired by it with integral pension. In these cases, mainly when employee earns a high salary, it is totally inadmissible, under the collectivity point of view, observed disparity between contributions amount and replacement rate of 100% of the last wage. Therefore, a requirement of ten year of service objectives to avoid such a situation, closing the flow of contributions and the flow of benefits.

This logic is also applied to the prerequisite of five years in the last public position before retirement. As a pension in the public sector does not consider the medium contribution-salary in the last years of employment, but only the last remuneration of a civil servant, this adjustment guarantees that at least for five years the flow of contributions are more compatible with the value of the pension.

Table 2 – Constraints to the Accumulation of Pension and Wage

1988 CONSTITUTION	AMENDMENT APPROVED
Maximum limit to wages and maximum limit to pensions.	Maximum limit to the amounts of wage and pension. * No transition rule, neither preservation of individual legal rights acquired before the Constitutional Amendment.
In accordance to the Supreme Court, accumulation between wage and pension was unconstitutional, except in cases of public functions that could be accumulated.	The accumulation of wage and pension was forbidden, except in cases of functions that could be accumulated and of income related to a position of trust in the Government. * The prohibition was not applied to civil servants that were in this situation when Amendment 20 was approved. Although, the maximum limit of income in the public sector should be applied to the sum of their wages and pensions.
In accordance to the Supreme Court, accumulation of pensions was unconstitutional, except in cases of public functions that could be accumulated.	The accumulation of pensions was forbidden (even between a pension of the retirement system of the public sector and of the public social insurance) * No transition rule, but preservation of acquired individual legal rights before Amendment 20, although with the total amount of accumulation of pensions restricted by the maximum limit of income in the public

1988 CONSTITUTION	AMENDMENT APPROVED
	sector.

The prohibition of accumulation of pensions also represents an adjustment measure in terms of public expenditures. However, the same is not true in relation to the prohibition of accumulation of pension and wage. This occurs because wages earned by retired civil servants will probably be paid to new civil servants. Consequently, in terms of reduction of fiscal expenditures, the impact tends to be very short.

Another important fiscal adjustment measure is the roof imposition to the total amount due to the accumulation of more than a pension or of pension and salary, in the case of civil servants that, at the approval of the Constitutional Amendment, were in this situation.

The opposite effect had to except civil servants that, at the approval of Amendment 20, were accumulating wage and pension. This occurred because the Amendment assured to these civil servants a right before considered unconstitutional by the Supreme Court.

Finally, the imposition of a roof to total income in the public sector is a quite complicated subject. Nowadays, all personal advantages are out of this maximum limit, due to a decision of the Supreme Court. Therefore, cases in that such a limit is surpassed are countless. Anyway, the Administrative Reform recently promulgated sought to solve such subject, although it still depends on enactment.

Table 3 – Definition and Following Monetary Adjustments of Pensions

1988 CONSTITUTION	AMENDMENT APPROVED
Value of pension based in the total wage of a civil servant before retirement (integral pension).	Maintenance of integral pension.
No restriction.	Pension should not be bigger than the last civil servant's wage
Linkage between monetary adjustments of wages of working civil servants and of pensions of those already retired and their dependents.	Maintenance of the linkage.

The Senate had approved the reduction of up to 30%, which would be applied on the income considered in the calculus of high-income civil servants' pensions (those who earn above the maximum benefit paid by the public social insurance, that is about US\$ 756). The objective was to restrain pension expenditures, mostly the higher ones, assuring, for civil servants whose income is under the roof of the public social insurance, a closer treatment with the beneficiaries of the private sector. However, as already mentioned, the reduction was suppressed by the Chamber of Deputies.

Anyway, senators, upon pressure by the Government, had established such a reduction to compensate the permanence, in the constitutional text, of the parity between readjustments of wages and pensions. The elimination of this parity, even at the Senate, a more conservative House, had no political conditions of succeeding, although it represented one of the Executive's principal goals.

According to the Government, such elimination was important in view of the expressive financial repercussion of this parity. Actually, it implicates that any monetary revision in incomes of working civil servants must be applied to pensions. This situation, besides to restrain improvements of specific civil servant's careers, has resulted in a substantial growth of payroll expenditures with retirees and pensioners, which are nowadays almost identical to expenditures with working civil servants.

At least it was prohibited that the value of pensions, for occasion of its concession, surpasses civil servants' last wage. This situation was quite onerous for public sector. However, it is worth to underline that such a situation still occurs in the retirement system of the Armed Forces.

Table 4 – Incidence of Social Contributions upon Pensions

1988 CONSTITUTION	AMENDMENT APPROVED
There was possibility.	Not permitted. * There is another Constitutional Amendment that intends to restore the incidence of these taxes.

Here, the Government goal was to increase social tax contribution collection in the short run. The argument for the incidence of social contributions upon pensions was, and continues to be, very reasonable. It is not fair or financially maintainable that public pensions, based on integral last wages of working civil servants and object of no social contributions, exceed, in net amount, their wages. Besides, the retirement system of the public sector is based in the "pay-as-you-go" system, where current pensions are financed by current contributions. In other words, it is not based on a fully-funded system, where civil servant's contributions are directed to his individual account. Therefore, it can not be argued that, for not giving right to a new benefit, the collection of contributions from pensioners is an improper appropriation. Actually, pensioners would be contributing to finance their own pensions.

In an attempt to approve the measure, the Senate decided that the contributions would only apply to higher pensions, those superior to the benefits' roof of the public social insurance. As the majority of civil servants earn less than this roof, a major part of pensioners would remain exempt. Furthermore, once again, the rule would give an equal treatment between retired civil servants whose income is up to the roof of the public social insurance and pensioners of the private sector, who are subject to the same limit and do not pay social contributions.

Nevertheless, the Chamber of Deputies, considering this payment unconstitutional, rejected the proposal. As it will be analyzed, the importance of the subject, as a short run measure of revenue increase, pushed the Government not to give up. In the following year, it sent to the Congress other bill on the subject, which, transformed in law, was later judged unconstitutional. After this, the Government sent a specific Constitutional Amendment bill trying again to establish the social contribution, which is being analyzed by the Congress.

Table 5 – Institution of Pension Funds for Civil Servants

1988 CONSTITUTION	AMENDMENT APPROVED
No reference about the subject.	<p>Possibility of institution of pension funds by the Union, States and Municipal branches, applying the special rules of the public sector's retirement system only to employees whose income is lower than the maximum pensions paid by the public social insurance. Therefore, for the others it will be the end of the integral pension.</p> <p>* This new rule applies only to new civil servants, although to those already in the public sector when Amendment 20 was approved is permitted to opt for the new system.</p>

For new civil servants, the ones hired after Amendment 20, changes will be much more significant than those so far mentioned. This will occur because the Government got to introduce a measure that certainly will mean radical change in the retirement system of the public sector, although the media and many observers had not given the due attention to it.

This so important measure is the possibility of establishment of pension funds by the Union, States and Municipal branches. These funds will cover only higher incomes in the public sector, because civil servants whose salary is up to the roof of public social insurance will continue to have their pensions ruled by special conditions of the retirement system of the public sector.

Such a possibility means the end of integral pensions and of its continuous parity with current wages for civil servants whose income is higher than the roof of public social insurance. In addition, the new situation maintains a trend of rules equalization among workers whose income is up to the roof of the public social insurance. No matter if these employees work in the private or public sector, their benefits will be based on "pay-as-you-go" system and will be subject to a roof which value is about ten minimum wages.

Additionally, the recent Administrative Reform (Amendment 18) will allow that new civil servants hired to work not in a State typical career (judge, inspector, etc) have their pension ruled by the public social insurance.

In the case of high-income workers, the pension related to the part of their income upper ten minimum wages will be based on the capitalization system of individual accounts. Furthermore, the pension from this system will probably be based on defined-contribution plans, where future benefits depend on the capitalization of contributions, instead of defined-benefit plans, where the value of the benefits is guaranteed no matter the amount accumulated in the individual account.

However, the new framework will only be applied, obligatorily, to new civil servants, that is, those hired after the enactment of the new constitutional devises. Thus, the repercussions of these changes will only occur in the long run.

Finally, it is worth mentioning that the new framework will be reinforced by another new device. Amendment 20 allows the establishment, by the Union, States, DC and Municipal districts, of funds – integrated by assets, resources of respective Treasures and of contributions – destined to the payment of pensions granted to the respective civil servants.

3.2 – Major Changes in the Public Social Insurance (Private Sector)

The rules concerning the public social insurance were not significantly altered, although it can be identified some important improvements.

The main modifications here focused are those that affect the public social insurance, as well as the financing of Social Security as a whole - which includes, besides the public social insurance, the areas of health and social assistance.

Such issues are presented in the following items:

- Social Security financing;
- length of service pensions;
- work-related accident insurance.

Table 6 – Social Security Financing

1988 CONSTITUTION	AMENDMENT APPROVED
Social contributions on wages (from employers and employees) were directed to the Social Security System as a whole (public social insurance, health and social assistance).	The social contributions based on wages will be directed only to the public social insurance (payroll taxes).
No reference about the subject	Permits that the Union establishes a special fund for pension payments.

It is important to underline that the linkage of payroll contribution only to expenditures in the public social insurance area does not mean more revenue to this area. Actually, these expenditures consummate all the coming resources of such a collection.

What may generate new resources for the public social insurance is Union institution of a fund of stock goods, rights and assets only to afford benefits expenditures. The volume of those resources, however, will depend, obviously, on the definition of papers and assets that will integrate this special fund.

Table 7 – Length of Service Pensions

1988 CONSTITUTION	AMENDMENT APPROVED
<p>Workers in general: – “<u>integral</u>”^(*): a) man: 35 years of service b) woman: 30 years</p>	<p>Workers in general: “<u>Integral</u>”^(*): maintenance of the rule, with the difference that, instead of considering the period of service, it is considered the period of contributions.</p>
<p>– <u>proportional</u>: a) man: 30 years of service b) woman: 25 years</p>	<p>– <u>proportional</u>: eliminated</p> <p>*<u>Transition rule</u>: - a plus in the contribution period equivalent to 40% of the period of contribution that was lacking (in December 1998) to amount 30 years of contributions, if man, or 25, if woman - + 53 years old, if man, or 48, if woman</p>
<p>Teachers: – <u>integral</u>: c) man: 30 years of service as a teacher d) woman: 25 years of service as a teacher</p>	<p>Teachers: – Maintenance of the especial benefit only for teachers in elementary, middle and high schools, but with minimum ages of 53 years, if man, or 48, if woman.</p> <p>* <u>Transition rule</u>: almost the same set for public sector teachers.</p>

^(*) *In the public social insurance, there is not an "integral pension" like that one existed in the civil servant's retirement system: pension equivalents to employee's last wage. Here, this kind of pension corresponded to 100% of contribution-wage until November 1999, when a new Law instituted a new criterion (Law 9.876, of November 26, 1999).*

The Government emphasized the end of pensions based in the period of service and wanted it substituted for one based on the amount of contributions. However, because the Congress allowed many exceptions to the rule, the change had few results.

As it was already mentioned, the requirement of a minimum age to be eligible to receive the length of contributions pension was not established in the private sector. This situation, beyond meaning that the conditions for receiving benefits continued to be almost the same for

pensioners of the public social insurance, introduced an outstanding differentiation in comparison with civil servants, for whose the requirement of a minimum age was introduced.

Finally, it is worth mentioning that the transition rules related to the end of the proportional pension assured a differentiated treatment between workers that were in the labor market at the Amendment 20 promulgation and those who entered in this market afterwards. Unlike the latter group of workers, the first ones continue to have the right to receive proportional pensions, although under quite more restrictive conditions. These conditions, under the point of view of expenditure control, will have a positive impact, because insured workers who were planning to retire earlier under the proportional pension will have to work longer.

Table 8 – Work-Related Accident Insurance

1988 CONSTITUTION	AMENDMENT APPROVED
<ul style="list-style-type: none"> - All workers have the right to the work-related accident insurance, sponsored by employers. - The public social insurance was responsible for providing this benefit. 	<ul style="list-style-type: none"> - The right was maintained. - The insurance was opened to the private sector (deregulation of the work-related accident insurance).

For many years the public social insurance has been responsible for providing work-related accident insurance. However, it was not always like this, having had periods when this benefit was the private sector's responsibility.

Alterations in this area mean that the insurance will return to the private sector. What is still unknown is in which conditions it will happen, considering that the change has not been enacted yet.

The fact that under the Amendment 20 a worker covered by a private work-related insurance can no longer receive the benefit from the public social insurance if he is a victim of a work-related accident is worrisome. In that case, it is important to be reminded that, when the mentioned insurance was responsibility of the private sector, it was common that accident victims did not receive the benefits immediately, mostly in the cases of high-value benefits. It happened because the insurance companies took a great deal of time trying to be sure about the accident characterization as work-related.

3.3 – Issues Linked to the Pension Funds System

In this area, as in others, the main objective was to reduce fiscal expenditures, in this case, those directed to pension funds sponsored by State owned companies. Besides this main goal, the improvement of the pension funds system as a whole represented other important purpose of the Government.

Two important devices must be stressed. The first establishes that the pension funds sponsored by state owned companies should review, in two years, their benefits and services plans, in the ways to implement an actuarial adjustment of their assets. In other words, this device required “financial and actuarial disciplines” in these funds. The second, and more important, is the new requirement of parity between the contributions of participants of pension funds and the contributions of the public sponsor.

It is important to underline that the introduction of this last device in the Constitution was fundamental, since it was the only way to limit public expenditures addressed to pension funds in operation. In such funds, the extremely generous rules of state sponsors were established in legal contracts among the parties, and, as such, could not be altered by law.

In general terms, Amendment 20 established that three laws should rule the Brazilian pension funds system:

- a) one concerning general rules of the pension funds system;
- b) one for the rules applied to the relationship between state owned companies and their pension funds;
- c) another with specific rules applying to institution of pension funds by the Union, States and Municipal branches.

Pension funds sponsored by the public sector have the largest slice of Brazilian pension funds’ patrimony, as well as have been the object of high public expenditures that, actually, should be controlled in order to guarantee the fiscal adjustment of the Government. In that way, the table following focuses, exclusively, the major changes related to those funds.

Table 9 – Funds Sponsored by State Owned Companies and by the State

1988 CONSTITUTION	AMENDMENT APPROVED
No reference to the subject.	A law should regulate the relationship between the Union, States, Municipal branches, their companies, foundations and institutions (as sponsors of pension funds) and their respective pension funds.
No reference to the subject.	Equivalence between contributions of the Union, States, Municipal branches, their companies, foundations and institutions and respective employees’ contributions. * This parity may be enforced in 2 years (from December 1999) or when the bill about the subject is approved.
No reference to the subject.	The pension funds were obligated to make many changes in order to guarantee their actuarial equilibrium in the medium and long run. These technical changes should be implemented in 2 years. In addition, criminal penalties established for administrators of pension funds and for those of state owned companies if they did not act correctly.

4 - ENACTMENT OF THE CONSTITUTIONAL AMENDMENT 20

The Constitutional Amendment 20 not only imposed immediate changes in the Brazilian Retirement System. It also opened "windows" for future changes through new laws about the subject (Amendment's enactment).

In this context, the three bills concerning the pension funds system have already been sent to the Congress. A law about rules applied in determination of pensions in the public social insurance was recently implemented. Additionally, the Congress is analyzing a Constitutional Amendment bill that tries to reintroduce social contributions on benefits paid to pensioners.

The analysis of these points of the recent evolution of the Retirement System Reform process is the focus of the following three sections.

4.1 - Pension Funds System

There are 353 private pension funds in Brazil, with a stock of resources equivalent to 11% of GDP (R\$ 93 billions) and 6.4 million participants and dependents. About 69% of this stock are owned by funds sponsored by public companies and the relationship among these companies and their funds has been a relevant focus for public deficit increase. Therefore, it is not surprising that the most important issues related to the subject in Amendment 20 are linked to the relationship of pension funds and their public sponsors.

Nonetheless, the Amendment proved more important to the revitalization of the system as a whole. Instead of limiting changes to the mentioned relationships, it opened ways to improve the private pension funds system as a whole.

At the beginning of the enactment process concerned to Constitutional Reform, the Government sent to the Congress, in March 1999, the three bills required by Amendment 20. Such propositions are, obviously, susceptible to changes. However, although the first two are still being analyzed by the Congress, the last one (general rules of the private pension funds system) is about to be approved, being, thus, object of more detailed analysis.

4.1.1 - Rules Applied to the Relationship between State owned Companies and their Pension Funds

The bill regulates new restrictions imposed by Amendment 20 to the relationship between state owned companies and their pension funds. It is important to underline that such restrictions are additional to the general rules which shall be observed by the whole private pension funds system, no matter if the pension fund is sponsored by the public sector or by the private one.

The proposal, besides regulating items destined to reduce the overload of the State in their financial support of the pension funds, looks for improving the control over these funds, as well as to impose rules that assure financial balance of these entities.

4.1.2 - Rules applied to the institution of Pension Funds by the Union, States and Municipal branches

The bill intends to enact the constitutional device that foresees, for new civil servants and for the current ones that opt by the new schedule, a mixed system of pensions. A part (up to the roof of public social insurance benefits) ruled by special characteristics of the retirement system of the public sector and another, for an additional pension to be established by the Union, States, DC and Municipal districts.

The institution of such differentiation will propitiate an huge reduction of the negative impact of pension expenses on the Brazilian public deficit in the long run. It will occur because public expenditures related to high-value pensions will be transferred to a new pension fund based on capitalization of new contributions. This positive impact will be strengthened by the new possibility of hiring employees in the public sector based on private sector labor rules (Administrative Constitutional Amendment 18) and, consequently, by correspondent future pensions based in the rules of the public social insurance.

Another point is that only federal, state or municipal law can institute a pension fund for their respective civil servants. Thus, the new frameworks will not depend only on the Federal Government.

Finally, it is important to highlight that this and prior bills so far summarized contain an element that represents a significant improvement in controlling public expenses. They enact the new and fundamental parity between contributions in the context of pension funds sponsored by state owned companies or directly by the State.

4.1.3 – General Rules of the Pension Funds System

The bill that establishes general rules for the Brazilian pension funds system (still established in Law 6.435, of July 15, 1977) represents a new pattern to the system. In general terms, it can be said that the proposal establishes essential conditions for the modernization of the whole private pension funds system in Brazil, which includes larger flexibility, credibility and transparency of the system, as well as invigoration of the regulation capacity and a better State control.

Although the bill preserves the basic organization of the system in closed (accessible only to sponsors' employees or to ones associated with an “institutor”) and opened pension funds (accessible to anybody), it changes the system’s focus to the plans for benefits. Thus, relevance is conferred to “multisponsored” entities (those that congregate more than a sponsor or “institutor”) and to “multiplans” (entities that administer plans for several groups of participants, with patrimonial independence).

These entities tend to reduce administrative costs, once the same managerial structure administers a diversity of plans, besides making possible to small sponsors or “institutors” offer pension plans to their employees or associated.

It is important to emphasize that, unlike other Latin-American experiences, Brazilians chose to preserve the optional character of the pension funds system. It is consistent with the maintenance of the public social insurance as central pillar of the Brazilian retirement system. Such an option differs, for instance, from the North American system, where the pension funds system has a basic character, not a complementary one, since those who do not have private pension plans receive benefits of social assistance extremely small, financed by general taxes collected of the whole society.

Inspired by the successful experiences in countries of the European Union and in the United States, a new form of constitution of closed pension funds was established, that will allow that entities of self-employees (associations, unions) can also institute, for their participants, pension plans. In these cases, the entity is named “institutor”. The intention is to open access to expressive portion of the Brazilian population to private pension plans, that are today restricted to employees of companies.

At the same time, the number of sponsors tends to increase, because the Union, States and Municipal districts will institute, as already seen, pension funds too. It shows the potential increase of the system in the medium and long run.

Other two relevant innovations are the "portability" and the "vesting" (differed benefit). The first means the possibility of transference, from an entity to another, of the savings accumulated by a participant. The second, the possibility to receive the savings as a differed proportional benefit. With these possibilities, a fired participant will be able to carry his savings to another pension fund or to receive benefits proportional to his period of contributions when becomes eligible to obtain them.

The modalities of plans were formally expanded, being stressed, besides the defined-benefit plans, the defined-contribution plans and those based on variable contributions.

The proposal emphasizes the institution of instruments that can assure the solvency of the benefits plans and its long run balance, establishing a series of measures for this end (maintenance of reserves, provisions, rules for investments, reinsurance operations or solvency funds).

Following international experience, the bill stimulates savings by exempting contributions from income tax, which will only be applied for the occasion of ransom or payment of the respective benefits.

Finally, it is settled down the institutional invigoration of the Federal Agency responsible for the regulation and supervision of private pension funds. In addition, the penalties for infractions are significantly increased.

In conclusion, the proposal analyzed here, if not changed, will be a relevant instrument for spreading private pension funds in Brazil.

4.2 - Institution of the "Retirement Factor"

As mentioned, the rejection of minimum limits of age for eligibility to receive the length of contributions pension paid by the public social insurance represented a hard blow to the Government. Actually, this measure was considered the most important to restrict public expenses in this system, and even a relevant measure of social justice.

Therefore, the Government, pressed by the necessity to adoption measures to control the ascending tendency in public social insurance expenses, sent to Congress a bill that, among other aspects, introduced a kind of "retirement factor" in the calculation of pensions. Such a bill passed and is now the Law 9.876, of November 26, 1999.

It is worth to point out that this Law includes not only the so called "retirement factor", having established several modifications destined to enlarge the coverage of the Brazilian public social insurance, which embrace only about 43% of the active economic population of 64.8 million Brazilians (excluded civil servants).

The intention is to bring for the system self-employees, domestic workers and entrepreneurs, that, in accordance with government estimates, represent almost 24 million people, which only 18,6% are participants in the public social insurance. It is really a necessary measure, in view of the fact that the great majority of the 19.4 million people not covered by any retirement system, when they lose their work capability, will demand assistance benefits, what will represent enormous cost for the society.

Nonetheless, in spite of the importance of the Law 9.876 to attract workers from informal labor market, the present analysis is centered in the "retirement factor", which represented the big "turn" of the Government in the political game involving the reform of the retirement system in Brazil.

Although it did not include limits of age for length of service pensions in private sector, Amendment 20 made way for substantial innovation in the calculation methodology of the wage-of-benefit of public social insurance participants. Actually, for the first time actuarial criteria was introduced in the methodology for computing pensions.

The Government succeeded in implementing the "retirement factor" based on two specific devises of the new constitutional text. First, the statement concerning the contributive character of the public social insurance and the requirement of actuarial and financial system balance (article 201). Second, the "desconstitucionalização" of value of benefit¹ calculation rule.

¹ Before, the Constitution established that wages-of-benefit would be equivalent to the medium of last 36 months of wages-of-contribution.

The great improvement of the new formula of wage-of-benefit is the insertion of a factor that includes life expectancy, age and period of contributions. In other words, it adds actuarial elements that increase the correlation between contributions and benefits. Furthermore, instead of considering only the last three years of contributions as the base for pensions, as before established in the Constitution, the new calculation considers the worker's entire labor life (starting from July of 1994).

With the new method, each beneficiary will receive a benefit calculated in accordance with the estimated amount of accomplished contributions, capitalized by a rate determined by the period of contributions and his age, as well as for the expectation of benefits duration.

The new equation is the following:

$$\mathbf{Sb} = \mathbf{M} \times \mathbf{f}$$

where:

Sb = wage-of-benefit (value of pension);

M = average of the 80% highest wages-of-contribution (value of the income up to the roof of the public social insurance, on which is applied the contribution tax) of insured worker during all his period of contributions, monetary adjusted by past inflation;

f = retirement factor, calculated as bellow:

$$\mathbf{f} = \frac{\mathbf{Tc} \times \mathbf{a}}{\mathbf{Es}} \times \left(1 + \frac{\mathbf{Id} + \mathbf{Tc} \times \mathbf{a}}{100}\right)$$

where:

Tc = contribution period of each insured worker (beneficiary);

a = contribution rate = 0,31 (20% due to the employer plus 11% due to the insured worker);

Es = life expectancy of the insured worker when he retires (the national average for both sexes supplied by the governmental institution), that is equivalent to the medium period that benefits will be received;

Id = insured worker age when he retires.

It can be noted that the equation adjusts the average of all wages-of-contribution of the insured worker by the "retirement factor".

The first part of the factor formula equalizes the contribution period of each beneficiary and the average period that benefits will be received (life expectancy at a certain age). For instance, consider an insured worker who has worked for 30 years. This worker's actual contribution period is 9.3 years (30 x 0.31). Therefore, if his life expectancy when he applies for pension is 9.3 years, the first part of the formula is balanced and will be 1.

The second part of the "retirement factor" formula is a bonus given to insured workers who keep on their activities, which, in certain way, can be associated to an interest rate. Thus, it is possible to make a capitalization of the resources accumulated over an insured worker's contribution period. It is important to stress that the interest rate is different depending on

when the worker begins to receive his pension. Those who leave the retirement system earlier will receive a lower bonus compared to those who keep on their activities for a longer period.

Payments based on lower interest rates to a insured worker who stays in the system for a shorter period is a fair criterion and, besides that, improves the cash flow performance. It occurs because insured workers that leave the system earlier will receive, in compensation, a lower benefit.

The new methodology makes pensions a function of the value and the period of contributions, introducing conditions to encourage workers to keep their activities even after fulfilling all legal requirements for retirement. Actually, it introduces to the "pay-as-you-go" system the equalization between contributions and benefits. Additionally, it allows demographic adjustments to be made inside the system, because the new rule considers both the increases in life expectancy age and the entrance or the exit dates in the pension calculus. Therefore, it means a significant step in the direction to a balanced retirement system.

It is worth to inform that the "retirement factor" is submitted to a transition rule. It is represented by a gradual application of the factor in a 1/60 per month proportion; that is, it will take 60 months to incorporate 100% of the factor (starting from November 1999). Furthermore, 5 additional years of contribution are given to all women and 5 (men) or 10 (women) years to elementary, middle and high school teachers.

In spite of all the advantages of the new calculus criteria, some specialists consider it is unconstitutional. They argue that it introduces age as a criterion for retirement. Also that it reduces the value of the pension for part of the insured workers that fulfill length of contributions requirement, that is the only one established by the Constitution.

The first argument is not valid, since the "retirement factor" is not presented as an eligibility condition for the benefit. Since an insured worker accomplishes the length of contribution necessary to receive the length of contribution pension or has the minimum age requested to be retired by old age, he is able to receive the benefit. What changed is the benefit calculation. Someone who opts to retire for length of contributions (35 years for men and 30 for women) in precocious age will deserve an inferior benefit than another that chooses to retire at a higher age. It will occur because the last one, besides having contributed for a larger period of time, will probably receive benefits for less time. Thus, it is fair that he receives a higher monthly income than the first insured worker does.

The second argument is also not correct. The Brazilian Constitution does not define the calculation rule of pensions anymore, which was transferred for law regulation. Nowadays, it determines only the minimum period of contributions required to receive the length of contributions pension. Therefore, it isn't correct to affirm that, once an insured worker reached the minimum period of contributions, the value of his pension has to be equal to 100% of his medium wages-of-contribution.

Actually, in March 2000, the Supreme Court rejected a petition by opposition politicians who claimed that the law was unconstitutional.

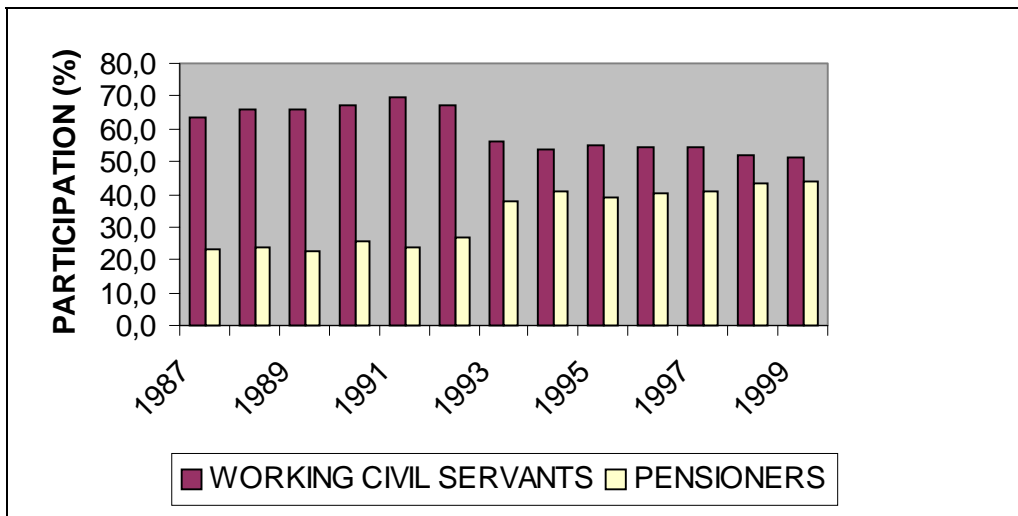
4.3 – Social Contributions of Pensioners

For the occasion of the Fiscal Adjustment Program of October 1998, the Brazilian Congress approved a new law that increased contributions paid by working civil servants and also determined that pensioners should contribute to their retirement system. However, the Supreme Court judged such law unconstitutional.

For the Government, such a decision meant a substantial defeat in its fiscal adjustment strategy. As it was already mentioned, the incidence of social contributions taken from the income of pensioners is fundamental for the fiscal deficit reduction, representing one of the few adjustment measures that has a short-term repercussion.

It is worth while to highlight the fact that, between 1987 and 1999, while the expenses with working civil servants practically doubled, the expenses with pensioners in general increased 4.5 times, with an ascending tendency (Graph 1). In the last twelve months ended in June 1999, accumulated expenses with pensioners consumed 44% of total payroll expenses. In other words, it was spent with pensioners almost the same amount due to working civil servants. It is estimated that the financing required for retirement system of the federal public sector (difference among expenses and social contributions collected for the system) has reached about R\$ 19.5 billion, in 1999, what represents 2% of Brazilian GDP.

**Graph 1 - Evolution of Pensions Participation in Total Payroll Expenses
(%) – 1987/1999***



Source: MP–Statistical Bulletin of Personnel, v.1, n° 39, jul/99

* Accumulated data from July 1998 to June 1999.

In this context, the Government did not give up and sent to the Congress a new Constitutional Amendment bill – PEC 136/99 in October 1999. This bill tries to reintroduce the contributions taken from the income of pensioners linked to the public sector (besides imposing

contributions also from retired members of Armed Forces). Therefore, the devise will be applied only to the portion of which individual pension is higher than R\$ 600 (about US\$ 320).

It is important to point out that many State Governments are supporting this new legislative proposition. This support is explained by the recognition that the pension financing is, nowadays, the major problem for the attainment of fiscal adjustment in all government levels (federal, regional and local) and that the collection of contribution from pensioners is essential to reduce the public sector deficit in the short run.

5 - FINANCIAL ANALYSIS AND PERSPECTIVES

In the almost four years that the Congress took to analyze the Constitutional Reform, the public finances scenery that motivated the Government to formulate it became progressively worse. Between 1995 and 1998, the deficit between the net collection of social contributions to the public social insurance and the expenses of the benefits increased from R\$ 1.2 billion to R\$ 7.7 billion (almost 1% of GDP). In 1999, although the deficit has reached R\$ 9.7 billion, its annual growth reduced. In effect, in 1997-98 period, the deficit more than doubled, while in 1999 it increased 26% (Table 10 and Graph 2). Such behavior reflects, among other factors, the approved Constitutional Reform, in the end of 1998, specially its repercussion in stopping the increasing of retirements for length of contributions.

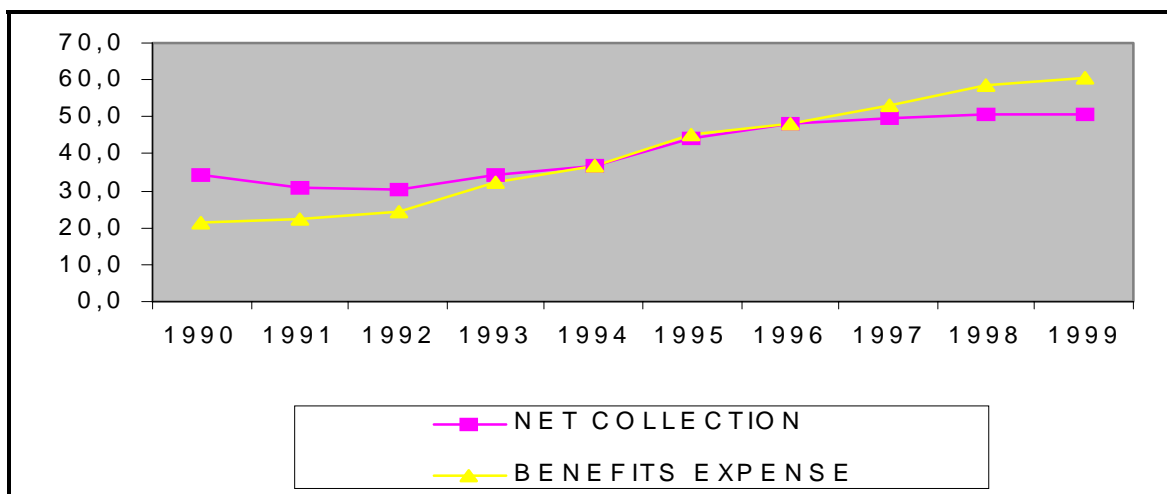
Table 10 – Relationship Between Net Collection and Expense with Benefits in the Public Social Insurance (R\$ billion of Dec/99 – INPC)*

YEAR	NET COLLECTION (A)	BENEFITS (B)	PARTICIPATION (%) C= (B/A)	RESULT D=(A-B)
1990	34,2	21,2	62,0	13,0
1991	30,7	22,2	72,0	8,5
1992	30,3	24,2	80,0	6,1
1993	34,4	32,5	94,0	1,9
1994	36,7	36,8	100,0	-0,8
1995	44,1	45,3	103,0	-1,1
1996	48,1	48,4	101,0	-0,3
1997	49,8	53,2	107,0	-3,5
1998	50,7	58,4	115,0	-7,7
1999	50,8	60,5	119,0	-9,7

Source: INSS

* Accumulated values until December of the current year, in December/99 prices (INPC)

Graph 2 - Public Social Insurance: Net Collection and Pensions Expenses Evolution - (1990/99)
(R\$ billion of Dec/99)



So

urce: INSS

Even so, the situation continues to be critical. Benefits expenses in the public social insurance system and in the retirement system of the public sector continue being the item that has the most impact on no-financial expenses of the Federal Government. Its participation between 1995 and 1999, increased from 51% to 55% (in 1987, such participation was 22%), even with the beginning enforcement of a series of restrictive measures, especially in the context of the retirement system of the public sector.

Anyway, the Brazilian public sector primary account (balance of income and non-debt related expenditures) has moved dramatically into surplus, going from a deficit of 0.92% of GDP in 1997 to surpluses of 0.01% and 3.13% in 1998 and 1999 respectively, what represents a very positive achievement.

In spite of such a behavior, the big villain of Brazil' public sector debt continues to be its financial component (cost of debt servicing: interest rates and amortization), which amount represents more than 50% of GDP, pushing net debt to around 47% of GDP, according to the Brazilian Treasury Department.

Actually, from 32.3% of GDP in 1995, the net public sector debt rose relatively modestly to 35.7% of GDP in 1997. However, the pace of the expansion has quickened since 1997, and the public debt reached 42.4% of GDP in December 1998, rising to 47% one year later. Debt related expenditures are now the principal cause of deficits, and the link between budget deficits and debt payments has become a vicious circle.

Therefore, it is clear that, in the absence of debt service obligations, the public sector would have accumulated net savings, enabling it to bring about a net retirement of debt.

In this discussion the about Brazilian public debt is also important to put the data concerning the public social insurance deficit in a proper context. Among the changes due to the 1988 Constitution, those referring to rural workers stand out: increase of benefits from half to one minimum wage; five years reduction in the ages and in the period of service necessary for retirement; and incorporation of thousands of workers that had never contributed to the public social insurance. Although such changes have represented a substantial social improvement, they were not accompanied by corresponding sources of revenues that could make possible a financial balance in the long run. In effect, contributions from rural area never surpassed 13% of total expenditures for rural benefits.

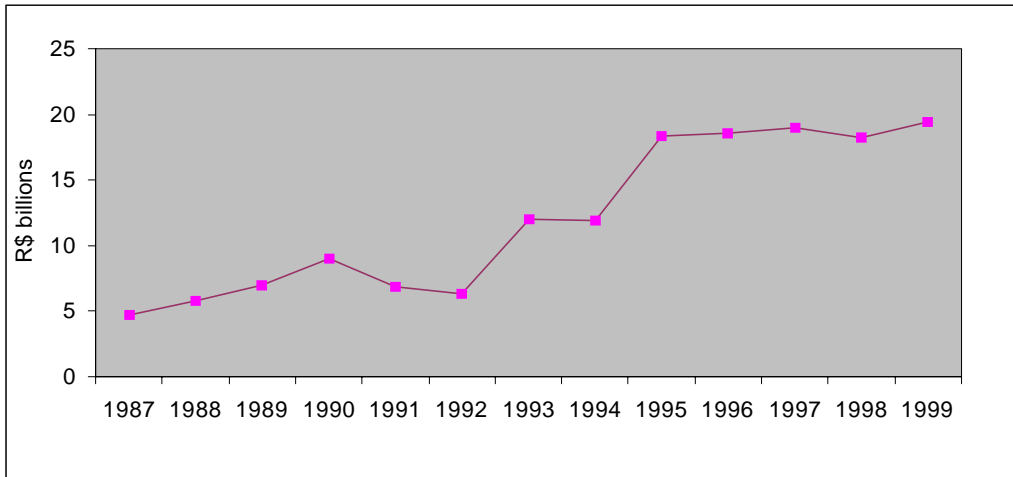
In this context, of the 11.8 million beneficiaries that earn a minimum benefit equivalent to one minimum wage, 6.1 million earn rural pensions for which contributions were just symbolic. They represent, thus, social assistance beneficiaries. As such, they should have the cost of their pensions financed by general taxes, not by specific contributions to the public social insurance.

Such discussion is essential, in order to analyze in an appropriate way the real amount of the public social insurance deficit.

The expenses with retired civil servants, by its turn, continue representing the most important pressure in governmental expenditures. It is estimated that, in 1999, while the retirement system of the public sector spent R\$ 43 billion/year with benefits payment to 2.5 million federal and state civil servants; the public social insurance spent R\$ 58 billion with 18.7 million beneficiaries. In other words, 10.8 % of the total beneficiaries in the two systems (civil servants) appropriate 42.5% of total expenses with benefits, while beneficiaries of the private sector, that represent 89.2% of the total beneficiaries, consume 57.5% of total expense. Such data show how privileged pensioners linked to the public sector are in relation to their companions of the private sector and how the retirement system of civil servants is still onerous.

The following graph displays the evolution of the difference between net collection of social contributions to the retirement system of the public sector (R\$ 3.7 billion, in 1999) and the expenses with benefits in this system (about R\$ 23 billion in 1999). It can be observed that this difference, called "financing need" of federal civil servants' retirement system, has been expanding along all the period, reaching expressive amounts in the last years.

Graph 3 – Evolution of "Financing Need" of Federal Civil Servants' Retirement System (1987-1999) *



Source: MPAS/PLO 2000

* Up to 1998, real values based in December/98 prices; in 1999, estimated nominal values

Here, it is also important to put data concerning the “financing need” in a proper context. This difference between contributions and expenses does not take in consideration that the Union, as an employer, shall participate in the financing of its retirement system by paying at least the same contributions that private employers do, that represents 22% of total payroll. Although, even considering such participation, that would mean R\$ 5.9 billion, it is noticed that the deficit continues to be significantly high: R\$ 13.5 billion in 1999.

In this context, it is not surprising that the Brazilian Retirement System Reform has had as a basic axis the contention of public expenses, as well as what also is happening in its enactment process.

However, no matter how urgent the fiscal adjustment is, when it is implemented adjustments in retirement systems is not proper to expect significant short-term financial repercussions. In general, changes in this area have relevant effects only in the long run, because it affects flows of expenses and revenues among generations.

Furthermore, when significant changes are implemented in a retirement system, it is not fair to equalize, in the short term, rights and obligations among generations. In other words, it is impossible to deal with equally those that still will enter in the retirement system, those already insured and those that receives benefits. This occurs because many individual decisions were made, taking into consideration the effective legal framework, making impossible for a lot of people to do unexpected adjustments.

It does not mean, however, that each of the involved groups – insured workers, beneficiaries and future participants – should not bend and make some necessary adjustments. On the contrary, it is important that this happens, in order not to impose an unbearable overload on future generations.

However, Brazilian citizens only now realize the magnitude of the problem with the Brazilian retirement system. In effect, after all discussions, the approved Constitutional Reform did not

lead to all necessary adjustments in the system. Onerous rules that constrains fiscal balance were maintained, even in the long term, as the non-inclusion of ages limit in the rules applied to the length of contributions pension in the private sector and the non-incidence of contributions to the income of pensioners linked to the public sector.

Anyway, considering all difficulties involved in a Constitutional Reform that affects the life of almost all citizens and, worse, that affects it in an unfavorable way - since it is mostly destined to reduce rights and advantages, especially of the more organized workers - the Government has introduced significant improvements in the Brazilian Retirement System.

Additionally, the Reform enactment process has been quite satisfactory. It has succeeded in implementing improvements and rationalization measures, exploring possibilities opened by the new constitutional text resultant of Amendment 20.

It is relevant to mention that there is no space for an increase in contribution rates, in view of the excessively high level of social contributions on wages. Therefore, there is space for revenue increment originated from the inclusion of workers from the informal labor market, many of them high-income self-employees.

In this context, a great effort to attract workers from the informal labor market is being initiated. Nowadays, only 4 out of 10 workers are covered by the public social insurance, what means that 19.4 million potentials insured workers are without any retirement system.

The following sections present some conclusions about the improvements achieved by Amendment 20 and its respective enactment.

5.1 - Parametric Adjustments in the Brazilian Retirement System

Summarizing, Brazil opted to implant important changes in its existing retirement systems instead of opting for structural changes.

However, the Government did not succeeded in modifying essential items, such as:

- a) ages limit in the public social retirement system;
- b) contributions of retired public civil servants and pensioners;
- c) linkage between salaries and pensions and integral pensions in the public sector;
- d) equal treatment between men and women, urban and rural workers and between teachers and other professionals;
- e) changes in the retirement system of the Armed Forces.

It can not be denied, however, that the improvements achieved are relevant, especially in terms of reducing privileges in the retirement system of the Brazilian public sector. New rules tend to close the gap between contributions and benefits, what will lead the system in the direction of actuarial balance in the long run.

Although civil servant's pension linkage to his last wage (integral pension) and to changes in wages of working civil servants remained, ten years in the public sector, five in the last public position and minimum ages are requested now. Such requirements guarantee, at least: better

correlation between the average of the last salaries and the pension; at least ten years of specific contributions for the public sector; and the end of precocious retirements.

In addition, there are two other extremely relevant factors for the future long-term balance in the retirement system of the public sector. First, the institution of a hybrid retirement system in this system, where only civil servants with smaller incomes will continue to have their pensions determined by the special rules of the public sector. Second, a hybrid system of new hiring practices will be implemented, where the major part of new employees will be hired through private sector rules (non-typical State careers) and, thus, will be covered by the public social insurance.

Anyway, it is fundamental to analyze the public sector's retirement system in its specific context. Unlike what happens in the private sector, who pays wages and pensions is the State, in the case of the public sector. Resources originate from the same source: the National Treasury. In other words, there is no difference, in financial terms, the Treasury allocates U\$1 thousand to pay the wage of a working civil servant and discounts from his salary U\$100 for his respective retirement system, or to pay him U\$900 and to allocate U\$100 for this same system.

The result is that the financial effect of directing a part of public pensions to finance the civil servants' retirement system is the same of leaving wages of thousands civil servants without monetary readjustment for six years, what the Government is implementing with very much success.

Under this point of view, to affirm that the contributions of civil servants are insufficient to afford their pensions is the same to say that working civil servants' wages provoke deficit because the taxes they pay are not enough to afford their salaries. Anyone can criticize that society is paying too much for especial retirements in the public sector or for the construction of a public building (a bridge or a highway). Nonetheless, it can not be denied that these expenditures are due to the society, in the same way that it is its responsibility to arch with the construction of a school and with the wages of its respective teachers.

It is also worth while to point out that the expressive elevation of expenses with retired civil servants in the last years is due to a isolated fact, which does not tend to occur again and which effects will be diluted in the long run. This fact was the transference - done by the Union, States and Municipal districts - of hundreds civil servants from the private to the public sector labor rules due to a new device introduced in the 1988 Constitution.

Finally, it is worth while to emphasize two recent and important improvements achieved in the current enactment of Amendment 20:

- (a) Law 9.717 (November 27, 1998), that, looking for to guarantee financial balance of retirement systems in the long run, establishes general rules for the organization and operation of individual retirement systems on the federal, regional and local government levels;
- (b) Law 9.796 (May 5, 1999), that establishes rules for the financial compensation between the public social insurance and the retirement systems of civil servants.

What needs to be done is to establish fundamental changes in the retirement system of Armed Forces. Its pension expenditures represent about 36% of total expenses with pensioners in the public sector as a whole, although military's contributions represent only 0.5% of total contributions collected from the two systems.

5.2 - Perspectives of the Pension Funds System

There is no doubt that the mentioned enactment process of Amendment 20 gives great perspectives for the expansion of Pension Funds System in Brazil.

Even with an archaic, inflexible and incentives free legislation, there are 353 pension funds in Brazil (69% of R\$93 billion total patrimony owned by entities sponsored by public companies) whose assets represent 11% of GDP and with 6.4 million beneficiaries, among participants and dependents.

It is obvious that, in countries where the private retirement system is already developed and consolidated, the participation of its assets in GDP is quite superior. For example, this participation reaches 120% of GDP in Holland, 100% in Switzerland, 78% in the United States and 40% in Japan.

Nonetheless, assuming a good legal framework, the potential increase of this system in Brazil tends to be huge. It is fundamental to observe that about 48 million Brazilian workers are not linked to any private retirement system and that, among them, at least 3 million represent high-salary qualified manpower (PNAD-IBGE data). Thus, they represent potential participants of private retirement funds.

Actually, with the new laws about the subject, the Government projects the duplication of pension funds' assets in five years. This means that these funds will have conditions to accumulated about R\$197 billion through 2005, which will be extremely beneficial for Brazilian development. Furthermore, the positive effects of this increase in the Brazilian financial system must be considered. Examples of this are: development of the national stock market, modernization of available financial instruments and larger supply of resources for medium and long run investment projects.

In the beginning of 90s, the Brazilian retirement system reform used to be approached in terms of options between public pay-as-you-go system versus fully-funded system and between defined-benefit plans versus defined-contribution plans. After one decade, the options were spread. Old faiths are contested today, like the affirmation that privatization of the public social insurance increases national savings (although its positive impact is confirmed in the development of the stock markets). Studies accomplished in Chile did not get to prove this assertive. In contrary, they found out that net balance of privatization, there undertaken more than 17 years ago, has been negative, in view of the high fiscal cost of transition.

In effect, privatization of the public retirement system represents a triple financial load to the State because it:

- a) is responsible for the public system deficit;

- b) has to transfer contributions from the old to the new system (in Chile, this was called “recognition bonus”);
- c) is responsible for a minimum pension to those who did not accumulate enough to finance their own pensions.

In the Brazilian case, it is estimated that such a cost would represent 2.5 times the GDP. Thus, considering the country's critical fiscal situation, it means that Brazil could never have opted for that alternative. Actually, Brazil spent a long time in discussions and analyses around in privatization alternatives to its retirement system, taking as model the three pillars World Bank proposal. After years of debates and studies, it can be said that the alternative chosen by the country did not copy any model adopted in other countries. The option was to adjust the positive elements of each model to the Brazilian reality.

In this context, it can be said that the Retirement System Reform undertook in Brazil, having already established important parametric adjustments, tries to consolidate an efficient mixed model of retirement system, stepped on two basic pillars. The first one embraces the public social insurance and the retirement system of a few civil servants (those employed in typical State careers) whose income is under the roof of the public social insurance, consolidated in accordance to actuarial basis and balanced in long run. The second pillar is a wide, flexible and efficient private retirement system.

It is important to stress that Amendment 20 will lead to increase the last pillar participation as the Brazilian national income expands. Such tendency exists because, instead of establishing the roof of the public social insurance in number of minimum wages, the Amendment established a nominal value (at that time it corresponded to 10 minimum wages), to be monetary adjusted. Therefore, as income “per-capita” increases, the workers' income will tend to surpass, more and more, the public social income roof. This situation will tend to stimulate workers, more and more, to participate in some private retirement plan, thus, expanding the private retirement system in Brazil.

5.3 - Repercussions of the "Retirement Factor"

The introduction of the "retirement factor" in the methodology of calculus of pensions in the public social insurance will have a high repercussion in the medium and long run. Actually, this new methodology represents a type of “virtual capitalization”. This means that workers' contributions, although continue being addressed to the payment of the current pensions, became to be counted in each worker's individual account.

If a worker accomplishes the minimum length of contributions or the minimum age required to be retired, he can begin to take out the accumulated resources in his “virtual” account. Such resources will correspond to the amount of his contributions divided by the expected period of benefits payment, capitalized by a type of implicit interest rate directly proportional to the beneficiary's age and to his period of contributions. As it was already mentioned, such a worker will be able to choose between continuing work and later receiving a high pension or retiring earlier with a smaller monthly income.

Although it does not eliminate the present deficit nor harm the acquired rights of retired workers, the new methodology allows stronger correlation between wages-of-contribution and wages-of-benefit for new retirements. In other words, pensions will begin to have narrow correlation with individual contributions, reducing implicit subsidies in the system. It also represents a significant improvement to the pay-as-you-go system, which is deeply affected by demographic changes. The increase in life expectancy for a certain age, for instance, requires periodical negotiations around minimum age limits. Once this variable is included in the new pension calculus, required adjustments will take place automatically, providing that the system is balanced. Considering that changes in the demographic profile of the Brazilian population have been huge (population in Brazil is aging faster than in European countries), it is easy to realize the importance of the new device.

Concluding, this new methodology represents a significant improvement in the basic pillar of the Brazilian Retirement System, which application in pensions' calculus will provide the stabilization of the public social insurance deficit, since new concessions will be based on actuarial criteria and not generators of additional deficits.

6 – FINAL COMMENTS

This study looked to present a wide vision of the recent Brazilian Retirement System Reform, in attempt of showing to those that criticize changes, affirming that nothing was made, that this is not true.

Certainly, the undertaken Reform was not the ideal one. However, it is important to have in mind that it was the possible Reform. Even so, it succeeded in moving forward significantly to guarantee a balanced system in the long run, besides having implanted several parametric adjustments that will allow stopping the increase of the deficit in the short run.

The problem is that need for the fiscal adjustment in Brazil is urgent. As a result, the reduction of the retirement system deficit is also urgent. In other words, it seems like something to be solved in the short run. However, the retirement system represents a long runs matter, in view the fact that it affects three generations –last, present and future. Besides, those majors interested in having a balanced retirement system are the members of the future generation that do not have political representation. The last (retired and pensioners) and present (active workers) generations, on the other hand, are those least interested in changes. This situation occurs because such adjustments represent, in general, losses of legal rights and privileges. As those generations enjoy significant political representation, they fight strongly against changes that implicate in losses in the short and medium run. This contradiction shows how difficult it is to promote short run changes in any retirement system.

Anyway, it is worth while to point out once again that the enactment process of Amendment 20 is being very well led, getting to explore, in the best possible way, alternatives for improvements made possible by the new constitutional text.

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