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**The Recent Trends in the Retirement System of Federal Civil Servants in Brazil**

**Eduardo da Silva Pereira**

# **THE RECENT TRENDES IN THE RETIREMENT SYSTEM OF FEDERAL CIVIL SERVANTS IN BRAZIL**

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## 1. Introduction

The Social Security system in Brazil has been facing some difficult challenges in recent years. Created in the beginning of the 20<sup>th</sup> century, the system had expanded along the years to cover all workers in the formal sector, including the rural workers and small farmers. This expansion was made in a context of a huge increase in the population and impressive economic growth. These two elements made easier to the administrators of the system to accommodate the potential imbalances created by the inclusion in the system of a growing number of workers with high ages, reduction in the criteria for eligibility and the increase in the value of benefits.

The positive aspect of this expansion was that it provided social protection for a number of workers that would face serious problems when they get old. The problem is that changes in the pattern of evolution of population, the reduction in the economic growth and the increase in the number of retirements turned into reality the potential imbalances in the system. Since 1995 the retirement system of private sector workers have presented negative cash flow and the system has been working through substantial transfers from the National Treasury.

In the public sector things are worse. Since the early 20<sup>th</sup> century the government has adopted a model for the retirement system of civil servants called *extended earning model*, in which the treasury makes the payment of retirement benefits. After the retirement the servants continues in the payroll, with their status changed from active to inactive workers. Until early nineties there were no provision to collect servant's contributions to their retirement system. Along the last six decades the benefits were progressively expanded and the conditions to retirement became the same or were reduced. No system to account separately the expenditures of retirement servants was established. No actuarial basis for benefits had existed. It can be said that retirement was not a concern for politicians, civil servants or even the society.

Only in the early nineties the problems of the social security system were included in the administrative agenda of the government. As the expenditures started to grow rapidly and the imbalances in the system started to be visible, the government tried to change the social security system in a way to achieve some level of control over the expenditure and to increase the revenues. As there was necessity of legislative approval to reform the system, the administration pushed the social security reform into the political agenda and tried to achieve some level of consensus to change the system. The changes that were made in the last ten years are the result of this movement.

It is worth to explain that the Brazilian social security system is compound of a set of different systems: the system that covers workers in the private sector; the system that covers civil servants<sup>1</sup>; a system to cover military servants; and a complementary system to private sector workers. All of these systems have problems related to their sustainability in the short or medium run. The efforts of reform in the nineties were addressed to all, except the military system.

In this paper we will look to the security system of federal civil servants, the biggest system of civil servants, trying to identify some elements in the system that led it to have the major financial gap between contributions and payments, this deficit reaching 2,0% of GDP in the year 2000<sup>2</sup>. We also will explore some of the reforms implemented in the nineties and look to the actual proposal of reform that are being discussed in the National Congress, trying to figure out the consequences of this proposal to the system.

As the objective of this paper is to deal with the civil servants of the Union, it will not cover the retirement systems of servants of states, municipalities and the federal military servants. It does not mean that these systems are not important. In fact, the number of servants covered by these sub national systems are greater than the number of the system of federal civil servants, and these systems also are facing huge deficits that together reach almost the same amount of the deficit in both federal systems, for civil and military servants. The decision to focus on the system for federal civil servants is derived from the diversity in the sub national systems, the importance of the unbalances in this system for the public finances and the demonstration effect that changes in this system can have for state and municipal systems. It is reasonable to believe that the analysis of the federal system can be useful for future works that deal with the other existing systems in the Brazilian public sector.

## **2. The Evolution of the Retirement System of Federal Civil Servants**

### **2.1. Historical evolution of retirement system of federal civil servants**

Brazil has a long tradition related to social security schemes. Beginning in the second half of 19th century, the federal government has started to implement retirement systems to assure to its workers some kind of support when they were unable to work. At the beginning this systems

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<sup>1</sup> Each State or municipality can create a specific system to its civil servants, following the rules mentioned in the Constitution. In 1997 there were around 2.850 retirement systems of civil servants.

<sup>2</sup> Cechin, J. (2002). pg 17

provide pensions to the military, the judges, the employees of National Treasury and workers in postal service. During the first half of 20th century the protection system of federal servants started to grow, expanding the number of insured persons and the situations in which benefits were provided. The government also created a retirement system for private sector workers. The social support for these workers was provided by a number of institutes organized accordingly to workers' categories, like banking, industry, retail and so on. In 1923, for example, the first law granting some private sector workers, in the railroads, pensions and health benefits was passed.

Following the general scheme adopted for private sector workers, in 1926 the Institute of Social Security of Union Employees was created, giving place in 1938 to the Instituto de Aposentadorias e Pensões dos Servidores Públicos – IPASE (Institute of Social Security and Social Assistance of Civil Servants), to manage the social security system for federal servants.

The IPASE was created four years after the promulgation of the Constitution of 1934. This Constitution established different social security rights to the private and the public sectors. Since this period the several constitutions promulgated in Brazil followed the same pattern and maintained or even widened the differences between these two groups of workers. Another important source of differences between the retirement systems of private and public sector workers was the complementary and ordinary laws that regulate the guidelines established in the constitution<sup>3</sup>.

Some important elements that nowadays characterize the retirement system of civil servants were introduced in the Constitutionss of 1934 and 1946, also being important the Statutes of Public Employees of 1939 and 1952.

The Constitution of 1934 established the right to retirement with whole wage to the servant in case of disability, since it counted at least 30 years of service<sup>4</sup>. “That right was equal, like this, to the current retirement for time of contribution, although associated to the condition of disability. Not verified the disability, the retirement would feel obligatory at age 68”<sup>5</sup>. This statement was not changed by the Constitution of 1937, that defined that the retirement of civil servants would occur if the servant completed 68 years old, if he/she became unable to work or if he/she suffered an accident at work causing his/her disability. The benefit will be proportional to the length of

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<sup>3</sup> In Brazilian's legal system complementary laws regulate the constitution and these laws are detailed by ordinary laws. There is a hierarchy between these norms.

<sup>4</sup> We call retirements with the whole last wage as a *full retirement*.

<sup>5</sup> Santos, L. A. (2000), pg 12.

service unless the servant has worked for more than 30 years. In case of accident at work, the benefit would be equal to the last wage. The Statute of Civil Servant of 1939 (Decree-Law<sup>6</sup> # 1.713/1939) complemented these rules. This Statute defined, for the first time, the retirement for length of service, granting this benefit to workers with 35 years of service and the pension was not less than 1/3 neither more than the last wage<sup>7</sup>. Also was created the figure of compulsory retirement independently of the age, meaning the right to the government to remove the servant according the interest of the service or “for convenience of the regime”.

The Constitution of 1946 established the retirement for length of service with 35 years of service, the benefit being equal to the whole wage if the worker has at least 30 years of service. In other cases the benefit was proportional. The other situations that make the servant able to be retired still were the same established by the Constitution of 1939. The Constitution of 1946 also index the benefits to wages of active servants, whenever their wages were actualized due to changes in the purchasing power of the currency (Art.193), and also rose the age for compulsory retirement to 70 years. Later, the new Statute of Civil Servants (Law # 1.711/1952), that substituted the Statute of 1939, established the reduction of length of service for voluntary retirement of women servants, which becomes entitled to retirement after 30 years of service.

The Constitution of 1967, and its amendment #1 of 1969, introduced few changes regarding the retirement system of civil servants. The basic elements that already exist in the Constitution of 1946 were kept. The provision of voluntary retirement of women with reduction of length of service was incorporated to the Constitution. This Constitution stated that the benefits would be equal to the last wage when the servant has completed 35 or 30 years of work, if men or women respectively. The amendment #18 of 1981 introduced a special retirement for teachers. The length of service to be retired was reduced for 30 or 25 years for men and women respectively<sup>8</sup>.

In the Federal Constitution of 1988 the retirement system of civil servants was a subject of extended and detailed coverage, as the retirement system of private sector. One of the reasons for this was that after 21 years of military rule the Constitutional Assembly was the arena where a wide range of social demands, that were unable to be discussed during the military regime, were

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<sup>6</sup> Decree-Law was a decree edited by the President that had the power of an ordinary law. It has immediate application and has to be approved by the Congress to become a law.

<sup>7</sup> According Santos, L. A. (2000), this benefit was characterized as a *prize* since it was conceded if the servant was judged “worthy of the prize, for the good and loyal services rendered to the public administration”.

<sup>8</sup> Provision valid for private sector teachers too.

presented and claimed attention by many interest groups. One of the most active group of interest that lobbied the Constitutional Assembly was the civil servants' group.

The pressure from these interest groups, associated with the fact that the political roots of many of the leaderships in the Assembly and in the States Governments had come from the populist political system of the fifties and sixties, led to a Constitution with two important characteristics. It was written in the Constitution a large set of social rights, not only in its general principles, but with a detailed set of operational definitions. These detailed definitions were also protected from easy change by creation of a long and complex legislative process to approve any constitutional amendment. Due to the recent experience of military rule, when laws could be changed solely by decision of the chief of executive branch, to insert in the Constitution as many rights as possible and protect it from easy change was a comprehensible strategy. The problem is that the strong constitutional commitment with a fair social order was not accompanied by concerns of how to finance the implementation of the social rights assured.

Regarding social security of civil servants, the consequence of this historic moment was materialized in Chapter VII, Sections I and II, related to the Public Administration and Civil Servants. There we have an detailed set of rules defining the rights, conditions and obligations of the civil servants and their employers, the Union, the States and municipalities.

Before analyzing the retirement system as it was designed in the Federal Constitution of 1988, an observation should be made. We shall notice that all these constitutions assure the right to retirement without contribution, following what is called *extended earning model*. In this model, pensions are regarded as extended earnings, to be paid out by the treasury in the same way as wages for public employees, so civil servants who were public officials during their active life are treated in the same way upon and during their retirement. The adoption of this model followed the practice in most OECD countries. This model is justified by the perception of civil service as a sacrifice. "A close link between retirement benefits and final salary was seen as a way to smooth income for a portion of labor force that choose to forgo higher earnings in the private sector"<sup>9</sup>.

It should be noticed that this model of retirement system for public servants does not imply that the servant do not have to contribute to the system. Although this model came to dominate in most countries, nowhere else the civil servants managed to guarantee the benefits as the ones

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<sup>9</sup> World Bank (2001). pg. 117.

provided by the Brazilian retirement system. In other systems, retirement benefits were never equal to the last salary, the retirement occur due to age and not by the length of service, the reference wage were a fraction of the last months salary and servants have to contribute to their retirement systems<sup>10</sup>.

Although the World Bank suggests that the extended earning model was adopted as a way to compensate civil servants for the higher earnings paid by the private sector, another interpretation can be made. In the Brazilian case the adoption of this model can be viewed as the adoption for civil servants of rules that are characteristically of the retirement system of military. To Brazilian military servants to be retired do not mean that their obligations to the state are finished. The relationship between the military servants and their employer still exists after the retirement, and they can be called back to service whenever the state needs it. The same logic can be applied to civil service, since the scheme of social protection for civil servants was created later than the system of protection for the military. Also, the civil service is build up based on a Weberian bureaucratic model in which the relationship of employees and employers is governed by rigid rules, similar to those applied to military. This made easier the adoption of military models in the civil service.

An argument so support this view is that all the statutes that ruled the civil service in Brazil since the thirties have a provision that make possible to the state to extinguish the benefit of a retired servant if he/she had violated the rules of the service when he/she had been working. This provision explicit that the relationship between the employee and employer still continues after retirement and shows that under the legal system, the retirement benefit is something that the servant has the right to receive but that under certain circumstances could be taken away. This condition also means that the retirement of civil servants is not something that the servant acquires with their contributions. One of the consequences of this logic is that none of the mentioned constitutions made a provision to make possible to the federal government to collect contributions on the servants to finance their retirements.

Another important element to be observed is that all these constitutions established that the retirement benefits of civil servants were equal to the last salary<sup>11</sup>. Technically it means that the

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<sup>10</sup> World Bank (2001). pg. 118.

<sup>11</sup> The constitutions of 1937 and 1946 established that the benefit should be proportional, 1/30 of the last salary per each year of work. As the retirement would occur after 35 years of work, it means that the benefit would be equal to the last salary, except when the servant was retired by disability, when the benefit would be proportional to the length of work.

replacement rate, that is the rate between the retirement benefit and the salary the servant received at work, was one. The source of this provision also can be traced in the military retirement system. The military retirement benefit in Brazil is not equal to the last salary, but the salary of the closest hierarchically level above the position the military occupied at the moment of retirement. Although this rule have not been used to civil servants, except for a short period of time, the high replacement rate provided to military was a parameter for civil servants. To support this inference we could argue that at least one of the statutes of civil servants established the same rule applied for military<sup>12</sup>.

## **2.2. The Federal Constitution of 1988 and its innovation regarding the retirement system of civil servants**

The Federal Constitution of 1988 brought, as mentioned, a wide detailed set of rules defining the rights, conditions and obligations of the civil servants and their employers, the Union, states and municipalities. The general rules applied to the Union also are applied to states and Municipalities, although the principle of autonomy of the federate entities allow them to adopt different approaches and implement different schemes to deal with the retirement of their servants.

The Federal Constitution of 1988 maintains the right to retirement according the length of service, defining this length as 35 years of service to man and 30 years to women. After this period the servant could retire with integral salary. This length of service could be smaller if the professional activity was considered painful, unhealthy or dangerous. Specific provision assured to teachers the right to full retirement at 30 years of service for man and 25 years of service for women.

The servant could opt to a earlier retirement, after 30 years of service if man and 25 years of service if women, with a benefit equal 70% of their wage plus 6% for each additional year of service until the limit of 5 years. It is also possible to a servant to retire with proportional benefits with the age of 65 years if man and 60 years if women. The servant would be obliged to retire with the age of 70 with proportional benefit. The retirement in case of permanent disability, due to accident in service and professional disease would be with integral salary. Some specific

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<sup>12</sup> The law 8.112/90 established that the retirement benefit would be equal to the salary of the level immediately above the level the servant occupied when he retired. This provision was eliminated in 1997.

provisions were made to allow the retirement of judges and public prosecutors with 30 years of service with integral salary.

It was assured to the servants, as to all workers, the right to count the length of service they have in the states' governments, Municipalities and in the private sector, being made a provision that systems should compensate the contributions made by the workers for each system, after her/his retirement.

The retirement benefits were indexed to the salary of active servants. So the benefits should be adjusted in the same proportion and in the same date of active servants, extending to the inactive any benefits or subsequent advantages given to the first ones. In the case of servant's death there is a survivor benefit equal to integral salary and indexed in the same way of others retirement benefits.

This set of rules were more detailed than the rules established by the previous constitutions and creates a system that provides wide coverage to civil servants. Critics have said that the retirement system of civil servants assure privileges to public workers in comparison with private sector workers' retirement system. This statement has been heard in almost every discussion about the reform of both systems. There is no doubt that the civil servants receive better benefits than the private sector workers and that inequality between these retirement systems is one of their major problems of Brazilian social security systems, but what is interesting to notice is that the conditions and rules to be eligible for retirement were basically the same for workers of the private sector, covered by the Regime Geral de Previdência Social (RGPS – Social Security General Regime) and of the public sector, covered by a great number of statutory systems maintained by the three levels of government.

This level of uniformity was attained due to the efforts of a political group presented in the National Assembly, that had the intention to create a comprehensive system of welfare that embraced all workers, goal that could be achieved more easily if the rules of retirement were the same in all systems<sup>13</sup>. The provision according to which each retirement system compensates each other by the rights the retired worker acquired in each of the systems is another element of this comprehensive view that drove this group of representatives in 1988. Other political groups have different views and the consequence was a Constitution with two different characteristics: in one hand it looked towards a more integrated system of social security; on the other hand it

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<sup>13</sup> One of the successful efforts of this group was the creation of a “Sistema Único de Saúde” (SUS - Unified System of Health) in the Constitution.

introduced provisions that widened the differences between the retirement systems of public and private sector workers.

But if the conditions to be retired are almost the same, what are the elements that explain why civil servant's benefits are so higher than private sector workers' benefits? What basically distinguish the systems are three elements: the rate of replacement (the initial value of the benefit), the benefit actualization rule and the non-existence of contributions of civil servants to their retirement system.

The rate of replacement for civil servants is equal to one, meaning that the benefit is equal to the servant's last wage. Workers in the private sector had their benefits equal to the average of the last 36 wages, limited to a ceiling<sup>14</sup>. If a worker has received more than the ceiling, he/she could acquire a private pension plan<sup>15</sup> to complement his/her benefit. One of the consequences of this rule is that the benefit paid to civil servants is much higher than the benefit paid to private sector workers, what can be seen on Table I.

Other difference between the systems was that the civil servant's benefit was linked to the salary of active civil servants. It means that anytime the government adjusted the salary of active workers, the benefits of retired civil servants were adjusted too. This linkage reduced the flexibility of the government related to human resources policies, since any change in the salaries has impact on the expenditure with retired servants. The retired workers of private sector had the right to have their benefits adjusted annually by the rate of inflation measured by a Consumer Price Index (CPI).

Finally the other important differentiation was that the adoption of an extreme generous concept of extended earning model excused civil servants to contribute to their retirement system. This was one of the most important difference between the retirement systems of public and private sector workers, and means that the retirement benefit of civil servant was entirely paid by taxpayers. On the other hand, the private sector retirement system had one of the world highest payroll taxes. Workers had to pay 11% of their wages limited to the ceiling and their employers had to pay 22% of the total payroll, without ceiling, to finance the RGPS.

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<sup>14</sup> The ceiling, at the time of promulgation of the constitution was equal to 10 minimum wages. It has being adjusted to the inflation but as the minimum wage has had real gains, nowadays the ceiling in RGPS is equal to 7.6 minimum wages.

<sup>15</sup> There are two kinds of pension plan. The system in which the employer sponsors a pension fund for its employee is known as closed pension fund. In the other system, known as open pension fund, banks and insurance companies offer pensions plans to anyone who wants to acquire it.

**Table I - Average retirement benefit of public servant – Brazil, 1995/2002  
(Current R\$)**

	Executive Branch (civil) <sup>1 2</sup>	Executive Branch (military) <sup>2</sup>	Legislative Branch <sup>2</sup>	Judiciary Branch <sup>2</sup>	RGPS <sup>4</sup>
1995	1.442	1.703	4.823	3.875	173
1996	1.530	1.737	5.577	3.945	209
1997	1.611	1.896	6.231	4.618	229
1998	1.693	2.225	6.882	5.222	250
1999	1.833	2.438	5.690	6.047	266
2000	1.914	2.544	5.342	6.185	288
2001	2.005	3.724	5.915	6.660	304
2002 <sup>3</sup>	2.124	3.693	6.492	6.873	-

Source: SRH/MP E STN/MF

1- Does not include state owned enterprises.

2- For 1995, 1996, 1997, 1998, 1999, 2000 e 2001, based on the annual average expenditure.

3 – Based on the average expenditure in the last 12 months.

4 – Source APSS/MPA calculated by the author

Looking to the previous constitutions, none of these elements of differentiation was new in the legal system. Table II compares the constitutions of 1937, 1946, 1967 and 1988 regard these elements. It shows that the Constitution of 1988 did not innovate when established these differentiation between the two retirement systems. In fact, analysing these constitutions we can see that these elements of differentiation has been part of the normative framework of Brazilian civil service since the thirties. So, its natural that civil servants look to this characteristics of their retirement system as a historical rights that have to be maintained.

With respect of these three elements, the main difference between the Constitution of 1988 and the previous constitutions is the indexation of retirement benefits to salary of active workers. In 1988 the Constitutional Assembly adopted a much wider concept of indexation than the Assemblies of 1946 and 1967 that restricted the indexation to cases in which the salaries of active workers are adjusted “due to the change in purchasing power of the currency”. Accordingly the Constitution of 1988 any change in the active worker salary should be immediately applied to retirement benefits, even if the raise in the salary was not related to change in purchasing power of the currency.

Since the Constitution of 1988 did not innovate related to civil servants retirement system, why there were so many claims to change the Constitution and why the huge deficits that exist in the retirement system of civil servants nowadays are blamed on it?

**Table II – Presence of some characteristics of civil servants retirement system in Brazilian Constitutions**

	Constitution			
	1937	1946	1967	1988
Retirement Benefit equal to last salary	Do not mention	Yes <sup>1</sup>	Yes <sup>1</sup>	Yes <sup>1</sup>
Retirement Benefit indexed to salary of active	Do not mention	Yes	Yes	Yes
Contributory retirement system	No	No	No	No

Source: Federal Legislation.

1 – Since others requisites are fulfilled

There are some reasons why the framework established by the Constitution of 1988 is considered one of the main reasons for the problems faced by the retirement system of civil servants. One of them is that creation of early retirement with proportional benefit provides a strong incentive to retirement, since the retired servant could retire at low ages, between 40 and 50 years, and continues to work, increasing his/her total earnings. Another reason is that the strongest linkage than existed in the past between salary of active workers and retirement benefits diminished the fear that future value of retirement benefit could be reduced in real terms, as a strategy to decrease the expenditure of public sector, providing another incentive to retirement.

Another provision in the Constitution of 1988, not directly related to the retirement system becomes an important element to affect the expenditure with the retirement system of civil servants. It is the provision that each level of government should adopt only one juridical status to their servants. Before 1988 the governments could hire people under two juridical statutes, the Statutory Regime and the same juridical status of private sector workers<sup>16</sup>. As the conditions to hire and managed people under the CLT were easier than under the Statutory Regime, that gave tenure to all workers after some time of work, between 1967 and 1988 the federal government hired a large number of *celetistas*. The consequence was that the minority of workers in public sector was civil servants when the Constitution of 1988 was promulgated<sup>17</sup>.

Other factor that have contributed to the expressive number of “*celetistas*” in the federal government was the expansion of the Brazilian State along the seventies and earlier eighties, due

<sup>16</sup> The workers under the juridical status of private sector workers are known as “*celetistas*”, word derived from the acronym CLT that mean “Consolidação das Leis do Trabalho” (consolidation of labor laws). To differentiate those two kinds of workers I will call the workers under the Statutory Regime as civil servants and the workers under the private sector regime as *celetistas*.

<sup>17</sup> The number of civil servants and *celetistas* at that time is unknown. The centralized control of payments to workers in the federal public sector was implemented in the mid nineties. Santos, L.A. (2002) and Cechin, J. (2002) suggests that in 1990 almost 80% of workers in the public sector were “*celetistas*”.

to policies implemented by the military that strength what in Brazil is called indirect public administration, a large number of organizations, that are linked and financed by the State but at that time were managed under the rules applied to the private sector. The Constitution of 1988 reduced the autonomy of these organizations, strengthened the control of the government over them and forced them to adopt to their worker the same juridical status adopted by the federal government.

As the *celetistas* worked under the juridical system of private sector workers, their retirement system was the same of these workers, the RGPS. So they contribute to the RGPS and receive retirement and other benefits from it. The federal government was like a regular employer and paid regular contributions to this system. It means that by 1988 the minority of civil servants was subjected to the retirement rules established in Federal Constitution and the generous retirement system of civil servants did not appear to be a problem since it would be applied to a relatively small number of servants.

But the provision that each government should adopt only one juridical status to workers in the public sector forced the government to define one. There were two options, adopt the Statutory Regime or the CLT Regime to all workers. But these two options were not real options, since some functions of civil servants can not be properly developed under the juridical status of private workers<sup>18</sup>. As a consequence the Federal Government adopt a Statutory Regime for its employees, what happened trough the Law 8.112, signed in December 11<sup>th</sup> of 1990. What is interesting in this law, regarding the retirement system of civil servants, is that it turns all federal government *celetistas* employees into civil servants, giving to them all the rights that the Constitution, as we saw above, has assured to civil servants.

The immediate consequence of the Law 8.112 was a huge increase in retirements in civil service since a great number of former *celetistas* has length of work enough to be retired at the time the law was passed or reached it soon later. These workers received an enormous benefit, since during their working lives they have contributed to the RGPS, which have a ceiling to contributions and benefits, and have been retired under the Statutory Regime, with retirement benefits equal to the last wage<sup>19</sup>. The burden of these benefits will be supported by Brazilian

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<sup>18</sup> This is the case of tax inspector, diplomats, federal police and others that need some protection in order to avoid external influences in his work. This protection does not exist in the juridical status of private sector, in which the employee can be fired or be punished depending on the will of the employer.

<sup>19</sup> In fact, as we mentioned, the law 8.112/90 has a provision that the servant will be promoted when he/she get retired.

society for long time since as there was not a minimum age to retirement these retirements happened at relatively young ages. Although there is no data about the age of retirement of civil servants before 1997, there is a belief that the average age of retirement with proportional benefit in the beginning of nineties was the same of the end of nineties, before the constitutional reform of 1998. It means that the average age of retirement for proportional and full benefit were 49 and 56 respectively. The Table III shows the number of retirements in federal civil service since 1991. Unfortunately there is no data about the number of monthly retirements before 1991, what makes impossible a precise evaluation of the impact of the Law 8.112. But we can see that the number of retirement reach 46 thousand in the first year after the introduction of the Law 8.112, and increase 118% in the ten years after the law, what shows the impact of this legislation on the retirement system of civil servants.

**Table III – Total of federal civil servants retired per year and average monthly retirement – 1991/2002**

	Retirement per year	Retirement per month	Total retired civil servants	Index 1991 =100
1990	-	-	198.678	100.00
1991	46.196	3.850	244.874	123.25
1992	21.190	1.766	266.064	133.92
1993	14.199	1.183	280.263	141.06
1994	17.601	1.467	297.864	149.92
1995	34.325	2.854	332.189	167.20
1996	27.546	2.296	359.735	181.06
1997	24.569	2.055	384.304	193.43
1998	19.755	1.646	404.059	203.37
1999	8.783	732	412.842	207.79
2000	5.951	496	418.793	210.79
2001	6.222	519	425.015	213.92
2002 <sup>1</sup>	3.534	589	428.549	215.70

Source: SRH/MP. Author's elaboration

1 –Until June/2002

The consequence of this huge growth in the number of retired civil servant and the other provisions that ruled the retirement of civil servant was an increase in the expenditure with retirement. As the retirement system of civil servant is not apart from the payroll of federal government, there were two main effects on public accounts. The first is that become increasingly difficult to the governments to execute their policies, since the growth of the expenditure with retired servants divert resources that could be applied in investments or in other current expenditures. The second is that the crescent participation of this expenditure in the budget made

more difficult to the government to achieve a balance in public accounts, what lead to a higher debt of public sector with its problems regard monetary policy and confidence in the government capacity of payment. The result is pressure for higher interest rates and reduced economic growth. The increase expenditure with the retirement system of civil servant also means transference of resources from the future generations to the present generation and it could have significant impact on the future capacity of growth and in the well being of the future generations when they become retired. It happens because the current generations of active workers have to pay increased tax to finance the difference between expenditures and revenues of retirement system of civil servants. The increased taxation has the effect to reduce the savings of current generation with its consequence in the reduction of investment and growth.

### **2.3. The main initiatives to reform the system in the last ten years**

#### **2.3.1. The contribution of active servants**

Soon the mentioned problems that arose with the Constitution of 1988 and the Law 8.112 were perceived. The first attempt to change what was established has focused on increase the contribution of civil servants to their retirement system. As we saw, the adoption of an extended earn model in Brazilian public sector has created a system in which the servants do not contribute to their retirement benefits. The only contribution that exists was the contribution to survivor benefit that was 6% of wages in 1988. So, create a contribution to the retirement system of civil servant was an obvious action to be taken to reduce the impact of the expenditure growth in the public accounts. In this way the Congress approved in 1993 the Constitutional Amendment #3, that introduced a new paragraph to the article 40 saying that “the pensions and survivor benefit of federal public servants shall be financed with resources from the Union and from contributions of civil servants, as the law determine”<sup>20</sup>.

With this amendment the retirement system of civil servants lost its characteristic of a right derived from the work in the civil service and its nature of a premium to be paid to the servant. This change creates the necessary legal support to the collection of this contribution, after the edition of a law that regulates it. It was the first time, since the thirties, when the retirement of civil servant become a subject in Brazilian constitutions, that was introduced a provision to collect contributions of civil servants to their retirement system.

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<sup>20</sup> Brasil (1993)

The Law #8.688/93 established that for one year the contributions of civil servants to their retirement system would vary from 9 to 12% of the total wage, being included in these rates the 6% already paid as a contribution to survivor benefit. The Union would contribute, as employer, with fiscal resources in the same amount of each servant, but become responsible to pay any difference between contributions and expenses. After the end of validity of this law, the administration issued the Provisional Measure #560<sup>21</sup> that maintained the same contributions. Finally, in April of 1997 the contributions were unified with the rate of 11% of the total wages.

With these regulations the government created a retirement system in which workers and employer, the Union, have to contribute and the current collected money should be used to pay current retirement benefits. In fact, what the government did was to create a pay-as-you-go model of retirement system for civil servants, as the retirement system of private workers, the RGPS. Pay-as-you-go systems are based on a principle that the current generation of workers pays the current expenditure with retired workers. In this system the initial contributions of the first generation of workers should be invested in a fund to create reserves to be used to cover eventual unbalance between contributions and payments.

The problem with that regulation is that the amount collected on the basis of 11% of wages of active workers is barely a fraction of the total expenditure with retired servants. It happens due to problems already mentioned in the structure of benefits of civil servants and also in the incorporation to the Statutory Regime of a great number of *celetistas* that have contributed to the retirement system of private workers, RGPS. The incorporation of ex-RGPS covered workers to the Statutory Regime could have less fiscal impacts if there were a compensation between the two systems, as determined by the Constitution of 1988. In this case the RGPS should transfer the amount of contributions of this “*celetistas*” to the National Treasury that will assume the payment of retirement benefits. The problem is that although the RGPS is a pay-as-you-go system it was managed without constitution of financial reserves to be used to support the payment of benefits when the first generation of insured workers became retired. It means that when the *celetistas* were transferred to the Statutory Regime, there were no funds in the RGPS to be used to finance at least a fraction of the retirement benefit that they became entitled to in this regime.

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<sup>21</sup> Provisional Measure is a legal instrument similar to the Decree-Law. The difference is that the Provisional Measure has validity of 30 days during which the Congress has to analyze the Provisional Measure. As the PM can be reedited until the Congress analyzes it, its validity can be much longer than the original 30 days. There are PM monthly reedited for more than 4 years.

The initial conditions of this pay-as-you-go retirement system were so extremely adverse that in 2001 the contribution rate to meet the revenue and the actual expenditure should be almost 21.8% of wages<sup>22</sup>. It is not difficult to imagine that a pay-as-you-go system that starts with this level of contribution will soon face financial problems. Two other characteristics of federal civil service have adverse implications to the financial viability of a pay-as-you-go system. One is that as the number of retired people and their correspondent expenditure had an enormous growth in the nineties, the number of active workers has decrease significantly, what can be see in the Table IV. As the number of contributors to the system has being reduced, the payroll available to be taxed to raise the contributions to the system has also reduced. The consequence is that unless there is an increase in the rate of contribution to the system, the revenue *vis-à-vis* the expenditures will decrease.

The other problem is that the average age of active civil servants is relatively high. Accordingly the Ministry of Planning the average age of a male civil servant is 46 years and a female civil servant is 44. Although these average ages do not looks so high to European or American standards, if we consider that the retirement in Brazil happen with 35 or 30 years of contribution to the system, and that people usually start to work between 16 and 20 years old, the actual average ages means that the average male and female civil servant will work only another 10 and 6 years before retirement respectively.

**Table IV – Number of active civil servants in the executive branch and in the three branches of government – 1991/2001**

Ano	Civil Servants - Executive	Index 1991 =100	Civil Servants – Three Branches	Index 1995 =100
1991	661.996	100.0	X	X
1992	683.618	103.3	X	X
1993	654.723	98.9	X	X
1994	641.564	96.9	X	X
1995	630.763	95.3	712.726	100.0
1996	606.952	91.7	694.221	97.4
1997	578.680	87.4	672.339	94.3
1998	564.320	85.2	659.314	92.5
1999	545.333	82.4	646.353	90.7
2000	536.321	81.0	636.711	89.3
2001	504.736	76.2	605.524	85.0

<sup>22</sup> 21.8% considering that the Union should contribute with the double of the contribution of servant, like in the RGPS, where the contribution is 11% for employee and 22% for employer. Using the criteria established by the Law 8.688/93, the contribution of servants should be 32.8%, the same of the Union. To be financed only with contributions of civil servants, the contribution should be 65.6% of the monthly wage.

Source: SRH/MP  
X = data not available

### **2.3.2. The contribution of retired servants**

Another element that the government tried to introduce in the legislation that ruled the retirement of civil servants was the contribution of retired servants. This is a controversial question that the government has tried to pass several times in the Congress and finally was rejected by the courts.

The first attempt to establish a contribution over the retirement benefits happened in May of 1996, when the Provisional Measure # 1.416 introduced this provision. This provision was based on the constitutional definition that the retirement benefit should be linked to the wages of active workers. On this principle the government argued that since there was a rule of equal treatment for the wages, there should be an equal treatment regarding contributions. But this Provisional Measure has little effect since, according Santos "...thousands of inactive servants obtained judicial provisions suspending the collection of the contribution. Most of the sentences were arrested to the fact of the collection was instituted through Provisional Measure, and not for law. In several States, state laws instituted taxation over the inactive servants and pensioners. The Law # 9.630/98 canceled the collection over retired and pensioners in the federal level. But in December of 1998, as part of adjustment compromises with the International Monetary Fund the President adopted a new Provisional Measure, that it was rejected by the Congress, and he sent in January 1999 a new bill of law to the Congress to reinstitute the contribution of retired and pensioners in the public service. This bill passed in the form of the Law # 9.783/99, that had its validity indeed initiate in June of 1999, after judicial decisions declaring it unconstitutional. In September of 1999, finally, the Supreme Federal Court decided to consider rates above 11% confiscatory and declared exempted of any contribution the retired ones and pensioners, benefiting all the federal servants."<sup>23</sup>

The contribution of retired civil servants is justifiable economically due to some characteristics of the majority of retired civil servants. As mentioned above a great number of retired civil servants had contributed to the retirement system of private workers, the RGPS, during the major part of their life. In this regime, the contribution was a fraction of the wage limited to a ceiling of 20 minimum wages, lately reduced to 10 minimum wages. It means that a worker who receives more

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<sup>23</sup> Santos, L. A. (2000). pg. 36.

than the ceiling has his/her contribution calculated limited to the ceiling. The benefit was also limited to that ceiling. But one of the characteristics of federal civil service is that a relatively high proportion of servants<sup>24</sup> have undergraduate courses, and their wages usually are higher than the ceiling. So, when these servants have retired in the Statutory Regime, their retirement benefits were higher than the amount used to calculate their contributions to the RGPS<sup>25</sup>. This difference between the contributions made by the servants and the benefits they can get mean that the system is unsustainable without transference of resources from the National Treasury. In this situation, the contribution on retired servants could be a way to reduce the imbalance in the system. Another reason to justify this contribution is that as the active servant pays a contribution of 11%<sup>26</sup> of his/her wage and the retired servant does not pay anything, the net revenue of retired servant is 11% higher than the active worker. As the source of funds for payments to retired and active servants is the same it means that the net expenditure of the National Treasury with a retired servant is 11% higher than the expenditure with this servant when he/she was working. This difference in taxation is an important incentive to early retirement in the civil service, and an element that contributes to unbalance the system. Implement a contribution on the retirement benefits of civil servant is a way to equalize the net revenue of active and retired civil servants eliminating the perverse incentives and negative economic effects this difference causes.

There are also some arguments based on equity to justify the contribution of retired civil servants. In a country that already had high levels of inequality the Law 8.112/90 only exacerbates this inequality, when it entitled the *celetistas* with the right to receive benefits for which they did not contribute. The huge transference of resources from the whole society to a relatively small group of civil servants that this law enabled is unjustifiable. The retirement of a great number of *celetistas* with benefits which they have never contributed to creates a deficit in the federal budget that in 2000 reach 16,8 billion of Reais<sup>27</sup>. This is almost the same amount of resources used to finance the federal expenditure with education and agriculture that year<sup>28</sup>, and means that this decision drain resources from other applications that can increase the level and quality of services provided by the federal government.

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<sup>24</sup> In June 2002, 39,3% of civil servants has higher education. Probably in the early nineties the number was lesser than this. In 1997 the data is 34,3% with higher education.

<sup>25</sup> We have to remember that there was no funds available in the RGPS to be transferred to the Statutory Regime, and that between 1991 and 1997 those servants that have retired got a promotion to the level immediately above the level his/her occupied at the time of retirement.

<sup>26</sup> After April 1997.

<sup>27</sup> Boletim Estatístico de Pessoal # 56. (2000).

<sup>28</sup> Accordingly the Federal Budget Secretariat that year the federal expenditure with education reach 10,6 billion of Reais and the expenditure with agriculture reach 5.1 billion of Reais.

The inequity of this decision is greater when we consider that this transference is not also from the society to a small group, but also from the future generations to the present generations. The reduction in the demographic growth will reduce the number of workers per retired person in the future, placing challenges for our pay-as-you-go system. The huge transference of resources from the current workers to current retirees, through increase in taxation to finance the retirement system of civil servants, only makes this problem worse once it reduce the capacity of savings from current workers with consequences for their ability to finance their retirement.

It is an example of the limits that the policy adopted in the early nineties regarding the retirement system of civil servants brought to the society. Implement a contribution over the retirement benefits of civil servant is a way to partially surpass these limits helping to free resources to be applied in a more productive way, increasing the potential growth of the economy and bring more equity to the society.

### **2.3.3. The Constitutional Amendment**

Besides this attempt to introduce contributive characteristics in the retirement system of civil servants, in mid nineties it was clear that there was a strong necessity of a pension reform, not only in the system for a private sector workers, but also in the system of public sector workers. The President Fernando Henrique Cardoso envisioned it and in the electoral race of 1994 introduced the pension reform in his government program. For the first time the social security appears as a problem in the public agenda and was presented the need for a deep reform in the system not to prevent problems, but to deal with problems that had yet arose.

It is not wrong to say that among the Brazilian population, there was little concern about retirement. The economic problems that have affected the Brazilian economy during the eighties and beginning of nineties, characterized by one of the higher inflation rates in the world, has focused the attention of people in the short run. The stabilization plan, implemented in mid 1994, has reduced the inflation to less than 6 or 7% a year, and create the possibility to people to look to the future. The reduction of inflation also exposed the existing deficit in the retirement system of civil servants and made clear that the retirement system of private sector workers was starting to get into increasing deficits. In this scenario, the retirement becomes a problem to people that started to realize that the structure of existent retirement system was unsustainable and that the

burden to support retired workers would jeopardize the economic growth necessary to assure the retirement of current and future generations.

In March of 1995, the President Fernando Henrique Cardoso, in the beginning of his first term, sent to the Congress a proposal of Constitutional Amendment to reform the social security systems of both, public and private sector workers. Despite the initial objective of build a tree pillar system<sup>29</sup> the government sent a more pragmatic proposal, considering that radical changes in the system would have little support in Congress and would not be approved. This proposal had the general objective “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”<sup>30</sup>. It means, the adoption of measures that have an immediate impact on the expenditure of pension system and that are consistent in the long run with a balanced system. The proposal included the maintenance of three different systems, for private sector worker, civil public sector workers and military; a huge equalization of rules among the systems; the maintenance of two pillars, the first, limited to ten minimum wages and the third, to those had income above this ceiling; the imposition of many parametric reforms in systems for private workers and civil servants and the withdrawal of Constitution of some operational details and make it easier to be regulated by law, that requires smaller quorum.

The government’s proposal stood in the Congress for a long time, almost three years and a half and the amendment approved was quite different from the original proposal. It was not unexpected that it happened, since pension reform is a subject that affects all the people in a country and the different positions of each group should be considered in the negotiations to produce a law that reflects the level of consensus in the society about this subject. It means that to reform the pension system is necessary to achieve a compromise between all groups in the society. It is an enormous task that takes time and sometimes has to be made step by step, using the last agreement as a base point to achieve higher levels of consensus and deeper reforms. So we can see the Constitutional Amendment #20 as a step in the process of reform the Brazilian pension system.

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<sup>29</sup> According the conceptualization adopted by World Bank, these three pillars are:  
a) a public basic pillar, based in the "pay-as-you-go" system, established to alleviate poverty and which the ceiling 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).

<sup>30</sup> Amaro, M. N. (2000). pg.5.

Adopting this point of view and contrary to what many critics have said this amendment was not a failure, and despite the fact that it was not the best technical solution to the problems of pension system, it was what the political forces represented in the Congress and in the Executive could achieve. Not being a sufficient technical solution for the existing problems means that another set of changes shall be made to adjust the system and to make possible the achievement of the goals expressed above.

The Constitutional Amendment #20 promulgated in December 16<sup>th</sup> of 1998, introduced some changes in the retirement system of civil servant. The main changes are show in the Table VI regarding their subject, retirement requisites, adjustment of retirement benefits and pension funds for civil servants.

**Table V – The main changes introduced by the Constitutional Amendment #20**

1988 Constitution	Constitutional Amendment #20
<b>Retirement Requisites</b>	
<i>Civil Servants in General:</i> With last wage: a) man: 35 years of service b) woman: 30 years	New Civil Servants With last wage: 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 For those who already are working in the civil service: - a plus in the contribution period equivalent to 20% of 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
<b>Retirement Requisites</b>	
– proportional to the last wage a) man: 30 years of service b) woman: 25 years	– proportional to the last wage: eliminated For those who already are working in the civil service - 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
<i>Teachers:</i> – integral: a) man: 30 years of service as a teacher b) woman: 25 years of service as a teacher	<i>Teachers:</i> – 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.
<i>Members of the Court:</i> – Integral: 30 years of service + 5 years in the public function as a member of the Court	<i>Members of the Court:</i> – The same rules applied to civil servants in general.
<b>Adjustment of Retirement Benefits</b>	

Linkage between monetary adjustments of wages of working civil servants and of pensions of those already retired and their dependents.	Maintenance of the linkage.
<b>Pension Funds for Civil Servants</b>	
No reference about the subject.	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.

The first objective was to change the benefit for length of service. It occurs because it is by far the most expensive retirement program, a result of the combination of relatively short period of contribution, high period of benefit payment, high replacement rate and high average wage of its beneficiaries.

One element that was changed was the definition that the benefit would not be granted by the length of service, but by the length of contribution. The objective was to explicit that the benefit was derived from the contributions paid to the system, and not from the time the worker has labored. Another important change is the introduction of an age limit to the retirement of length of contribution. For the new servants, hired after the Constitutional Amendment #20, the retirement will occur on the age of 60 if man and 55 if women. Although these ages do not look high it is the first time the Brazilian legislation mentioned this kind of restriction to retirement based on length of contribution. Another important restriction is the exigency of ten years of public service and five years in the last public function to the civil servant to be retired. It was intended to avoid opportunistic behavior from private sector workers that could join the civil service near the time to be eligible for retirement to receive better benefits than those paid by the retirement system of private sector workers. For current civil servants the Constitutional Amendment establish limits of age of 53 and 48 years of service for men and women, respectively to the retirement for length of contribution, and what was called “a toll” that increase the length of contribution necessary to the retirement. The special benefit that made possible for teachers and members of the court to be retired with fewer length of service than the other workers was modified. For teachers the special benefit was limited to elementary, middle and high schools and for members of the courts it was extinct. The proportional benefit, that allows civil servant to be retired with 30 or 25 years of service, with reduced benefit was extinct. For current civil servants there are another “toll” that makes more difficult to get this kind of benefit.

According Amaro, M. N. (2000) “All these changes in the retirement of length of service 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”<sup>31</sup>. But these changes are widely recognized as insufficient to deal with the problems the retirement system of civil system is facing. There are some structural problems that have not been successfully addressed in the proposal approved by the Congress.

As we have mentioned, in the Federal Constitution of 1988 there were three main differences between the retirement system of civil servants and private sector workers. These differences were the rate of replacement, the rule of benefit’s actualization and the non-contributory status of civil servants retirement system. At the time of promulgation of Constitutional Amendment # 20 the non-contributory status of civil servants retirement system was already modified by the Constitutional Amendment # 3/93, but the two other elements of differentiation were not changed at that time, and are still valid today.

The original amendment sent to the Congress by the government tried to deal with these problems through the extinction of the links between the current wages of civil servant and the retirement benefits. There were two proposals addressed to this goal, one was the introduction of indexation of retirement benefits to a price index, providing protection against the inflation and avoiding the linkage between the wages of active workers and retired workers. The other was the reduction in the replacement rate of retired servant through the change in the formula used to calculate the retirement benefit and avoiding payments equal to the last wage. The retirement benefit will be calculated using the same formula valid to calculate the benefits of private sector workers, providing an important equalization of rules<sup>32</sup>. The Congress decided to maintain the original provision of the Constitution of 1988 and rejected both proposals.

Another important change introduced by the Constitutional Amendment was the possibility for the governments to create pension funds to complement the benefits of civil servant. The provision is that if the federal, state or local government desire, it will be possible to reduce the payment of retirement benefits directly by the respective treasury to the ceiling valid for the private sector workers retirement system. Those servants that receive more than that ceiling will

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<sup>31</sup> Amaro, M. N. (2000). pg.8.

<sup>32</sup> The Constitutional Amendment # 20 withdrawal the benefit formula used to calculate the benefit of private sector workers from the Constitution. The Law 9.876/92 has changed the formula from the average of last 36 wages to a complex formula with actuarial elements that use a greater length of contributions to calculate the value of benefit.

have to have a pension fund, sponsored by the respective government to complement his/her benefit. This measure represents another equalization of rules between the retirement system of civil servants and the retirement system of private sector workers, since it creates the possibility to governments to create a multi pillar system to its servants. The impact of this measure could be strengthened by the possibility of governments to hire servants under different juridical status than the Statutory Regime.<sup>33</sup>

#### **2.4. The actual system**

In the last section we described the major changes introduced by the Constitutional Amendment #20 regarding the retirement system of civil servants. This section will analyze the actual retirement system of civil servants, trying to figure out the major problems that still exist in this system and describe the main features that make it unsustainable in the long run.

Today the retirement system of civil servants provides retirement benefits for more than 400,000 civil servants and survivor benefits for more than 220,000 dependents. There are almost 605,000 civil servants contributing to the system<sup>34</sup>.

As we have already mentioned the retirement system of civil servants is a formidable and mounting burden on Brazil's public resources, and presents an immediate challenge to the Government objective of fiscal solvency. To the extent that RJU deficits are financed from federal, state and municipal treasuries, the cost of generous public-sector pensions is passed on to current and future taxpayers.

Retirement benefits paid by the federal RJU are more generous than those paid by the system for private-sector workers. In 1997, the ratio of the average annual benefit paid by the federal RJU to the average contribution was roughly 7:1, against 3:1 in retirement system of private sector workers. The ratios of the average monthly pensions paid to retirees from the executive, legislative and judiciary branches, to the average monthly salary paid to active workers in each branch were 108%, 103% and 140%, respectively.<sup>35</sup>

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<sup>33</sup> The Law 9.962/00 have created this possibility after the Constitutional Amendment #19/98 had modified the provision determining the existence of one unique juridical status in the civil service.

<sup>34</sup> Boletim Estatístico de Pessoal #75. (2002), pg. 21.

<sup>35</sup> World Bank. (2001). pg 93.

The retirement system of civil servants is also generous to the orphaned children and surviving spouses of deceased public sector workers. The orphans of civil servants can receive benefits until they reach 21 years of age, while the spouses receives the benefit throughout their lifetime, as in the retirement system of private sector workers<sup>36</sup>. As with pensions, survivor benefits rise with every increase in the current salary of the government position the deceased occupied while in active service. From January to July 2002, the federal government made payments to the survivors of former active and retired civil servants in the amount of R\$ 5,1 billion<sup>37</sup>. In a system that is only a decade old, this figure shows a massive financial burden in the near future.

Considering the financial aspects of the system, it is a pay-as-you-go system, in which there is no reserve fund for payment of retirement servants. It is a reflex of the earlier approach to the retirement of civil servants, which was viewed as part of the payroll. In this situation, there is no sense in the constitution of a fund to pay the retirement benefits. Without any fund to support the payment of benefits, the total expenditure of the National Treasury with personnel of the federal government - salaries for active workers and pensions of current retirees – has increased in the past twelve years. Annual personnel expenditure has risen by R\$25.1 billion between 1987 and 2000, as showed in the Table VI. Over the same period retirement payments as a portion of personnel expenditure have risen at a much faster rate.

**Table VI – Federal expenditure with personnel – 1987-2000**

	Personnel Expenditure (Billions R\$)	Index 1987=100	Wages 1987=100	Retirement and Survivors Benefits 1987=100
1987	19,7	100,0	100,0	100,0
1988	24,2	122,7	127,3	125,5
1989	29,9	151,6	156,7	149,7
1990	34,4	174,7	184,9	194,0
1991	28,2	143,3	156,9	148,0
1992	23	116,7	123,1	135,5
1993	31,1	157,7	138,5	257,2
1994	35,9	181,9	154,3	321,2
1995	46,6	236,5	204,6	397,3
1996	45,3	229,8	196,8	400,9
1997	45,7	231,7	197,3	411,6
1998	47,4	240,5	197,6	448,5

<sup>36</sup> The spouses and unmarried daughters of deceased military can receive pensions throughout their lifetime. Accordingly the World Bank in 1999 the cost of these survivor benefits was about R\$900 million, more than the capital budget of the armed forces.

<sup>37</sup> Boletim Estatístico de Pessoal #75. (2002), pg. 9.

1999	45,7	231,9	185,4	447,3
2000	44,8	227,5	192,1	412,2

Source: SRH/MP Boletim Estatístico de Pessoal, no 56/2000 p.35

1 - Adjusted by IGP-DI (General Price Index)

2 - Included Survivor Benefits

3 - Included military personnel

This means that there is an increase in governmental expenditures that does not provide any return to the society. It happens because the government can not replace all the retired servants, once if it would be done there would be a huge increase in the global expenditure with personnel. So the government has do adopt a policy to constrain the hire of new servants<sup>38</sup>. The consequence is that although the total expenditure has increased, the proportion of personnel expenditure paid to retired servants has increased much faster and the proportion of active servants, that provide services to the society, has decreased.

The huge increase in the expenditure with retired people has impact on the financial accounts of the system. Table VII show clearly the gap between revenues and expenditures of the system. This gap is paid out of the federal government's revenues from general taxation. For benefit payments to be brought into balance with contributions with no change in the current benefit structure, civil servants' mandatory contribution rate would have to be raised dramatically. Facing this numbers no one can deny that the current benefit and contribution parameters of the retirement system of civil servant are unsustainable. This conclusion remains the same even if we consider that the government has to make a contribution as employer, and we use the same rate of contribution applied in RGPS, as we can see in the last row of Table VII.

**Table VII – Contributions, Benefits and Deficit of Retirement Systems of Federal Civil Servants and Private Sector Workers – 1997-2001**  
R\$ Billions

Retirement System of Federal Civil Servants							
	1995	1996	1997	1998	1999	2000	2001
Contributions	2,1	2,6	2,6	2,5	3,1	2,7	3,7
Retirement and survivors benefits	15,3	16,6	18,4	20,8	23,1	25,0	28,1
Deficit	13,2	14,0	15,8	18,3	20,0	22,2	24,4
Deficit considering Government as employer	9,0	8,8	10,6	13,3	13,8	16,9	17,0
Retirement System of Private Sector Workers							
Contributions	32,2	40,4	44,1	46,6	49,1	55,7	62,5
Retirement and survivors benefits	32,6	40,6	47,2	53,7	58,5	65,8	75,3
Deficit	0,4	0,2	3,1	7,1	9,4	10,1	12,8

Source: Cechin, J. (2002). Pg. 17

<sup>38</sup> According the Ministry of Planning, 51.583 civil servants were hired between 1995 and 2001. In this period the number of retirements reached 127.151.

Some studies about the Brazilian social security system show that the deficit that already exists will grow in the future. The World Bank prepared a report in which there is some estimative for the evolution of the deficit for retirement system of civil servants in some scenarios. The results vary, depending on the assumptions made in each scenario<sup>39</sup>. In the scenario 1, which the Bank assumes is most likely to happen, the system will follow the patterns showed in the Table VII.

**Table VIII – Result for a Simulation of Evolution of the Retirement System of Federal Civil Servants**

		Scenario 1	Scenario 2
RJU Deficit Billions R\$			
	2000	18,2	18,2
	2010	50,8	50,8
	2030	323,6	323,6
	2075	10.515,0	10.515,0
RJU Deficit as % of GNP			
	2000	1,7	1,7
	2010	2,1	1,8
	2030	2,7	1,6
	2075	2,6	0,6
Affordable Contribution %		>80	>80
Affordable Replacement %		6	6
NPV Financing Gap (R\$ Billion)		-440,1	-440,1
IPD as % of GDP			
	2000	20,9	20,9
	2010	36,8	31,3
	2030	41,9	24,2
	2075	39,8	9,7

Source: World Bank Staff Estimates (PROST Simulations), 1999  
World Bank. (2001). Pg. 99.

Table VIII shown that the retirement system of civil servant will run into growing deficits, even assuming a positively macroeconomic environment, which is unlikely as the deficit grow. The financing gap widens rapidly to 2.1% of national income in 2010, and 2.7% in 2030. The net present value of the accumulated deficits throughout the simulation horizon is R\$440 billion, or about half of Brazil's expected GDP in 1999.

The rates of replacement existing nowadays cannot be sustained by an 11% rate of contribution. For the net present value (NPV) of the current balance between contributions and payments to the

<sup>39</sup> The main parameters scenario 1 are: GDP growth, 3%, Productivity Growth, 2,5%, Inflation Rate, 5% and Real Interest Rate, 6%. To scenario 2 the parameters are GDP growth, 5%, Productive Growth, 2,5%, Inflation Rate, 5% and Real Interest Rate, 6%.

system to be zero, the average rate of replacement would have to be lowered to 6%, while contributions would have to be raised to 87% in 2000 and to well over 100% shortly thereafter. Obviously this kind of parametric adjustment in a pay-as-you-go system is economically inconceivable and politically unviable.

The recent changes introduced in the recent reform do not seem to be enough to deal with the imbalance existing in the system. The World Bank's report introduced the changes brought by the Constitutional Amendment #20 and the results are significant, since the implicit pension debt (IPD) is lowered from 21 to 18% of GDP in the year 2000 and from 36,8 to 30% in 2010<sup>40</sup>. The operational deficit goes from R\$ 17 billion in 2000 to R\$ 289 billion in 2030. The NPV of accumulated deficits to 2075 has been reduced to R\$ 392 billion. But the conclusion is that "Although these savings are substantial, the fiscal burden of the Federal RJU remains financially unsustainable"<sup>41</sup>

The multiple scenarios designed by the World Bank also make clear that the rate of growth of wages of active servants is one of the most important variables to define the path of the financing gap in the long run. This correlation is not surprising, due to the benefit formula and the indexation of benefits to growth in current wages. *Caeteris Paribus*, an increase of one percent in the rate of productivity of work, which is the growth of wages, in the scenario 1 increases the NPV of the financing gap by R\$ 85 billion.

Other work published by the Instituto de Pesquisa Econômica Aplicada (IPEA)<sup>42</sup>, a federal institute for economic research, has shown that the last reform would provide some relief until the year 2006/2007, when the deficit in the system will start to be greater than it would be if there were no reform. At 2025 the researcher's forecast is that the financing gap will be higher as 3.2% of GDP.

There are two reasons why the work of IPEA reached this conclusion. First there was an assumption that the human resource policy of the government will favor the hire of servants with at least bachelor degree, expanding the participation of these workers in the federal labor force.

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<sup>40</sup> The commitment of the plan provider to pay pensions to both, the current retired servants and the active servants, when they retire means that the government has a liability with its employees. The amount of funds the government would need to face its obligations is the hidden implicit debt of social security or implicit pension debt. World Bank. (2001). pg. 100.

<sup>41</sup> World Bank. (2001). pg. 102.

<sup>42</sup> Beltrão, K. I., Oliveira, F. E. B., Pasinato, M. T. M. (1999). *Modelo de Simulação de Longo Prazo das Receitas e Despesas com o Funcionalismo Público Federal*. Textos para Discussão # 678. Rio de Janeiro. IPEA.

As these workers usually are better paid than workers with medium level of education, it will increase the implicit pension debt. The other assumption was that the extinction of the proportional retirement would lead to a higher expenditure in the future, once the servants will be retired later but with higher benefits. Although the first assumption is derived from a human resource policy envisioned by the former Ministry of Administration and State Reform, it is extremely dependent of how future governments will deal with this issue, and despite its importance for the model results, other assumptions have to be considered.

The second assumption is more important, since it is an effect of what already happened, the extinction of proportional retirement. In this matter, the report of World Bank agrees with the paper of IPEA, and adds one important consideration. Analyzing the retirement system of private sector workers, which has its proportional retirement extinct too, the bank has concluded that “Although the most difficult of the 1998 reforms-and that with the most important medium and long term implications-the removal of the Constitutional guarantee did not on its own lower the regime's liabilities. **Without a new benefit formula, the elimination of early retirement (*aposentadoria proporcional*) actually increases the government's pension liabilities**”<sup>43</sup>. To the private sector workers regime the change in the benefit formula comes with the Law 9.876/99, but to the retirement system of civil servants, the benefit formula did not change.

There is another study that presents results in an opposite direction than those from World Bank and IPEA. An article published in a newsletter of the Ministério da Previdência e Assistência Social (Ministry of Social Security and Social Assistance)<sup>44</sup> presented an analysis of the expenditures and revenues for the retirement system of civil servants in the long run. The researchers made an assumption of growth of 3.5% and 1.5% a year for GDP and wages, respectively. The most important assumption is that the number of civil servants will drop from five hundred thousand in 2002 to one hundred thousand in the 2030. The main result of this simulation is that the financing gap between contributions and benefits will be reduced in the long run, and will be around 0,35% of GDP in 2075. This result is remarkably different from those found by World Bank and IPEA, that have identified a growth in the financial gap in the long run, even considering the reforms approved. But these studies have not considered the reduction on the number of civil servants covered by the retirement system of civil servant. It is extremely

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<sup>43</sup> World Bank. (2001). pg. 57.

<sup>44</sup> Pinheiro, V., Caetano, M. A. (2002). *Previdência e Assistência Social – Tendências de Longo Prazo*. Informe da Previdência Social. Vol. 14. # 04. Brasília, Ministério da Previdência e Assistência Social.

important since as the government reduce the number of servants hired under the actual system the potential deficit became smaller.

The assumption that the number of civil servants covered by the retirement system of civil servants will be reduced is consequence of the Constitutional Amendment # 19/98 that reintroduced the possibility for government to hire people under the juridical status of *celetistas*. This amendment has extinct the obligation for only one juridical regime in the public service and allow government to hire servants under the CLT regime, as the governments before the Constitution of 1988 had<sup>45</sup>. The regulation of amendment #19 established the existence of “strategic carriers” that should continue to be ruled by the Statutory Regime, what was made with intention to give to members of these carriers higher degree of protection against political influence on their work<sup>46</sup>. In 1999 the government sent to the Congress a proposal defining which are the “strategic carriers” but this proposal have not passed yet. There is a discussion, with the lobby of civil servants is trying to include in the definition a wide range of carriers, while the government is trying to limit this range to a few carriers. What is important is that whatever will be the result of this discussion, the federal government will have the possibility to reduce the number of civil servants that would be retired within the actual rules. It is important to notice that the new servants, hired under the Statutory Regime have a minimum age for retirement, what help to reduce the imbalance in the system. The forecast of MPAS is that the numbers of public workers covered by the actual Statutory Regime will drop from 500 thousand until it reaches 100 thousand in the early thirties.

One of the problems with the study of MPAS is that they do not consider some elements that can have strongly impact on the results found. The study did not consider as expenditure with social security the payments that will have to be made to the retirement system of private sector workers to cover the benefits of *celetistas* workers<sup>47</sup>. The payments the government would have to make to pension funds to complement the retirement benefit of *celetistas* workers also did not was

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<sup>45</sup> Those *celetistas* will be covered by the retirement system of private sector workers, with the government contributing to their retirement as a regular employer. The rules applied to them will be the same of the private sector workers, including the ceiling in benefits.

<sup>46</sup> The idea is to keep carriers that execute functions of police, foreign relations, advocacy, high level management, budget and financing and some other in the Statutory Regime.

<sup>47</sup> This contribution would be equal to 22% of the total wages.

considered<sup>48</sup>. As these factors affects the expenditure with the retirement system of public sector workers, the results presented should be viewed with caution.

Also important to notice is that if the strategy of the government to deal with the problem of retirement system of civil servants is only start to hire servants under the CLT rule, the existing problems will not be solved, but only change in size. It means that the deficits will be more manageable and the fiscal impact will be reduced, but the subsidies, the incentives to early retirement and the deficits will still be there.

To achieve the results forecasted in these studies it would be necessary an average GDP growth of 3,0% a year or more in the long run, what seems relatively difficult since few of the last 20 years have presented a GDP growth like this. Here is important to stress the importance of GDP growth to reduce the proportion of the financing imbalance of the retirement system of civil servants. The analysis of World Bank assumes that the scenario more likely to happened will have a GDP growth of 3% a year but the another scenario presented in Table VIII have an assumption of GDP growth of 5% a year. Despite the fact that the absolute numbers of the deficit still remain the same in scenario 2, the numbers that show the relative importance of these deficits are much smaller than in the scenario 1, what make the problem easier to solve.

Another way to assess the viability of the actual system and the impact of the reform of 1998 is to calculate the internal rate of return of contributions to the system. Since the retirement system can be view as an “investment” made by individuals, the internal rate of return of this “investment” is helpful to assess the return of this “investment” compared with other investments, and to compare different benefit plans. The Table IX shows the interest rate of return calculated by World Bank for civil servant, before and after the Constitutional Amendment #20. There should be noticed that this simulation assumes a history of contributions by civil servants and thus only illustrates returns to workers who entered in the civil service after 1993, when the contribution to the system was introduced. Those who have entered the system before 1993 will have rates of return significantly higher than those found. The ages presented in the Table IX represents respectively: 1) teacher of both sex qualifying for proportional retirement, 2) teachers qualifying for full retirement and non-teachers qualifying for proportional retirement, 3) non-teachers qualifying for full retirement. It was considered 21 years as the initial age of contribution

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<sup>48</sup> Despite the fact that there is no obligation for the government to provide a complementary system for those *celetistas* who receives more than the ceiling, it is clear that as the number of this workers grow, the pressure to create a pension fund for this workers will make it unavoidable.

**Table IX – Internal Rates of Return for the Retirement System of Federal Civil Servants (%)**

Civil Servant Type	Pre-Reform	Post-Reform
Men		
21-46 years	11,1	8,2
21-51 years	9,6	7,0
21-56 years	8,5	6,3
Women		
21-41 years	14,8	11,6
21-46 years	13,0	10,1
21-51 years	12,7	10,6

Source: World Bank. (2001). pg.101.

The Table IX shown that the rates of return for retirement for length of service favor those who retire early. The internal rates of return are higher than the market return for investment on financial market for small investor (assumed at 6% real a year). It means that for all civil servants there is a positive transfer for the system beneficiaries. The rates of return for women teachers are higher than the other servants, what is expected since women usually have a higher life expectancy than men and the retired age for teachers are below the age for other servants. As a consequence of this difference of life expectancy and age of retirement in the retirement system of civil servants women earn higher returns than their male counterparts.

Even after the reform of 1998 the internal rates of return of retired civil servants are significantly higher than the average market rate. Only for male non-teacher qualifying for full retirement the rate of return is similar to the market rate. For women the rate is well above the market rate. This numbers show that the parametric reforms implemented in 1998 have reduced the generosity of the system, but remain the structural characteristics that favor civil servants compared to private sector workers. The results for the scenario post reform have considered a contribution on retired servants and an additional on the contributions of active civil servants, approved in January 1999 and considered unconstitutional by the Supremo Tribunal Federal (Federal Supreme Court) in September of 1999. It means that nowadays the rates of returns in the scenario post-reform are higher than those found in the World Bank study.

Another problem of the actual system is a consequence of different rules applied to private and public sector workers. Since the two systems have different eligibility rules and ceilings for benefits, there are low incentives for mobility from the public sector to the private sector. On the other hand, there are strong incentives for workers with relatively high age join the civil service once he/she can get a much more generous retirement benefit than in the private sector. So, the

far the equalization of rules, criteria of eligibility and calculus of benefit goes, the more these distortions in the labour market will be reduced.

The retirement system of civil servant is being transformed from a regime to pay civil servants proportional or integral wages for life, based on a generous extended earning model in a classical pay-as-you-go system due to changes implemented along the nineties. It has been made through tightened eligibility criteria and the introduction of contribution from the workers covered. In this process, it has been clear that the system is fiscally unsustainable, once it was created with huge debts with retired and active workers. This debt can not be paid through contributions of workers and retired servants without disproportional contributions from the employer, the federal government. As the government does not produce its resources, only taking them from people and companies, these disproportional contributions means a subsidy to civil servants by the whole society. As the system works in the PAYG model, due to its generosity, it also implicitly transfers wealth from future generations to current workers/retirees, increasing the characteristics of inequality in this system.

The process of reform of the retirement system of civil servant has been increased the perception that these subsidies are unfairly generous relatively to the system for private sector workers. This generosity can be seen in the internal rates of return enjoyed by civil servants. These subsidies also drain resources from other uses where it could be helpful to reduce social problems and benefit those citizens more needy than civil servants and increase expenditures that does not provide any return to taxpayers.

The difference between expenditures and revenues of the retirement system of civil servant is the financial face of these subsidies. When this deficit is compared with the deficits in the retirement system for private sector workers it is clear that the major fiscal impact in the national public finance came from the retirement system of public service<sup>49</sup>. Thus the best result for the finance of public sector can be obtained through the reform of retirement system for federal civil servants.

As we have seen, the origin of this deficit lies on three provisions that makes the retirement system of civil servants extremely generous to covered workers: a) the replacement rate equal to one, b) the adjustment of benefits accordingly the adjustment of wages of active workers and c) the non-contributory nature of the system. Reform the system to achieve some degree of

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<sup>49</sup>Including civil and military retirement systems. When we consider the deficits of the retirement systems of civil servants of States and Municipalities the fiscal impact in national accounts of the deficits in retirement systems of public service double.

sustainability only can be made through changes in these elements. The reforms that took place in the nineties changed only the non-contributory nature of the system and that is one of the reasons these reforms only provided a temporary fiscal relief, reducing the deficit's rate of growth. To achieve a solution to the problems of the system, changes in these elements have to be made.

Some of the reforms have created opportunities to address some of these elements and create a system that could respond to the fiscal and equity problems that exists nowadays. In the next section we will discuss some of these opportunities, trying to identify some problems for their implementation and some consequences to the government and civil service.

### **3. The Proposal for a New System**

#### **3.1. The complementary laws**

The reforms implemented in the nineties have created opportunities to address some of the problems in the existing retirement system of civil servants. What is interesting is that these opportunities were not created accordingly a previous plan of the government, but are a result of the legal and political process to reform the retirement system of civil servants. The main changes in the system that were proposed as a package by the government in 1995 were negotiated in Congress in pieces, resulting that some items were approved, some rejected and others modified without concern about the final design of the system. Although sometimes this process lead to backwards in the social security reform, it also opened some paths to advance the process of reform.

After the promulgation of the Constitutional Amendment #20 and due to difficulty and time expended to achieve results that, as mentioned, were insufficient to guarantee the desired goals, the original objective to implement changes that could affect immediately the system seems to be abandoned. The approach of the government for the retirement system of civil servant has moved from a change in the actual system toward a vision focused on a) the progressive reduction of the number of servants that can be entitled to the benefits provided by the actual system and b) the reduction in the maximum benefits paid by this system.

In this new vision, there will be two groups of public workers, the civil servants and the *celetistas*. The civil servants will be a reduced number of people that will work in specific areas of the government. The *celetistas* will be the majority of public workers and will be covered by

the retirement system of private sector workers. It means that they will not receive any benefit from the National Treasury when they will retire. The civil servants will be only a reduced number of civil servants covered by the actual retirement system of civil servants. These workers would receive their retirement benefits from the National Treasury, but in a different way than today.

The Constitutional Amendment opened the possibility to governments to create pension funds to face the expenditures with the retirement benefits of civil servants. To those civil servants that would be covered by these funds, the maximum benefit to be paid by the National Treasury would be equal to the maximum benefit paid by the retirement system of private sector workers. If the civil servant would have a wage above this ceiling, the fund would pay a complementary benefit that, ad to the benefit paid by the National Treasury, could not be greater than the ceiling to wages in the public sector<sup>50</sup>. With this design the retirement system of civil servants would have two pillars, becoming similar to the system for private sector workers. The complementary system, or the second pillar, would be a fully funded system operating capitalization accounts.

In 1999 the government send to the Congress the Projeto de Lei Complementar #9 (PLC #9 – Complementary Law Proposal) defining the rules to implement these pension funds in the three levels of government. This proposal has been object of great discussion and it has not passed yet. Certainly the strong lobby of civil servants helped to block the advance of the proposal but it seems that also important was what could be called the exhaustion of the government that spend all the 1<sup>st</sup> term of President Fernando Henrique Cardoso in intense discussions to have the Constitutional Amendment # 20 approved. The perspective to have to spend the 2<sup>d</sup> term in another fierce discussion over the same subject could have diminished the will to fight to have this proposal approved<sup>51</sup>.

The PLC #9 establish a framework within with the three levels of government would implement the civil servant retirement complementary system. The main features of the proposal are:

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<sup>50</sup> Accordingly Brazilian laws the civil servant can not receive wages above the wages paid to the President, to the President of the Congress and to the Ministries of the Federal Supreme Court. Despite these laws, this ceiling is surpassed through a series of bureaucratic interpretations and there is not enough effort to enforce it. In June/2002, 1,4% of the active servants and 3,7% of the retired servants received wages/benefits above this ceiling.

<sup>51</sup> We also have to consider that after the devaluation of the national currency in January/1999 the popular support for the re-elected president dropped significantly.

- ? If any government would decide to create a pension fund for its civil servants, it would limit the benefit to be paid by the government to the ceiling established in the retirement system of private sector workers;
- ? The pension fund would have to be managed by an entity separated from the government and subjected to the regulation already existent to the pension funds for private sector workers. In federal, state or local level would have only one entity to manage the pension fund;
- ? The regulation and supervision of these funds would be made by the agency responsible for the private pension funds<sup>52</sup>;
- ? The new system would be mandatory for new civil servants hired after the pension fund implementation. The law that would create the pension fund would offer to those who are already servants the option to change for the new system. In this case when the servant become retired the government would pay a benefit proportional to the length of service previous to the date he/she changed to the new system. The government would have the option to transfer to the fund reserves equal to the past contributions of the civil servant that change for the new system.
- ? The PLC #9 also establish that the law that creates the pension fund could offer the possibility to *celetistas* join the system as a way to complement the retirement provided by the retirement system of private sector workers;
- ? Although the PLC #9 does not oblige funds to implement defined contribution plans, as the benefit plans would have to be approved by the federal regulatory agency, certainly the funds would be pushed towards defined contributions plans;
- ? Workers and employees would have to contribute to the pension fund with 1:1 proportionality;
- ? The pension funds would be prohibited to make loans or to finance covered workers or plan sponsors. The only exception would be investment in public bonds issued by the Federal Government.

Together with this proposal the government sent to the Congress other two Complementary Laws Proposals to establish the institutional relationship between government agencies, state owned companies and pension funds and to consolidate all rules regarding pension funds for private sector workers. These two proposals were approved and become laws in May 2001. The new

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<sup>52</sup> Nowadays the regulation and supervision is made by the Secretaria de Previdência Complementar do MPAS (Complementary Social Security Secretariat)

rules defined by these two laws will also be applied to the new pension funds for civil servants and they provide a much better regulatory framework than the previous legislation.

As can easily be seen this kind of pension fund only will be viable if two of the elements that are sources of unbalance in the actual retirement system of civil servants will not be present, the rate of replacement equal to one and the adjustment of retirement benefits accordingly the adjustment of active servants. In fact when the Constitutional Amendment #20 has made possible the creation of this kind of pension fund it opened the possibility to by pass the other constitutional provisions that introduced this elements in the retirement system of civil servant. It will happen if the regulatory agency, using the powers defined in the Complementary Laws already approved, establishes that the pension funds will have to provide definition contribution plans. In this kind of plan, it is technically impossible to guarantee that the retirement benefit will be equal to the last wage of the civil servant<sup>53</sup>. The benefit would be defined by the amount of reserves the individual would be able to accumulate, the profitability of pension fund investments and he/she life expectancy<sup>54</sup>. This also means that to guarantee the pension fund solvency without additional contributions from the employer the benefit adjustment can not be equal to the adjustment in wages of active servants, and must be related to a index commonly used in the financial market and other variables like the life expectancy of the retired servant.

Another positive aspect of this proposal is that it is a clear advance towards a more uniform retirement system between public and private sector workers. As the design of the new system encompass the creation of a two pillars system for the public sector workers, with the same benefit ceiling, an important step would be taken to eliminate one of the problems of the actual design. The proposal advance in this direction but as we will see some important differences still exist.

The implementation of complementary pension funds for civil servants is an important improvement in the retirement system of civil servants but some questions arise with a more cautiously analysis. The first question is that the legal framework for the new system does not exist yet. All the two legal central pieces for the new system have not been approved. The proposal that defines which are the “strategic careers” that will be ruled by the Statute of Civil Servant is in the National Congress since 1999 as the PLC #9. Get these proposals approved is *sine qua non* condition to implement the new system. The delay to have these proposals approved

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<sup>53</sup> Only civil servants that receive less than the ceiling would receive benefits equal to the last wage. In July 2002 the number of servants in this situation was 48,2%.

<sup>54</sup> Another factors can influence the benefit, like the existence of accessory benefits (survivors benefit, etc.)

means that each year a number of servants join the civil service under the actual system, increasing the potential deficit<sup>55</sup>. Another important legal factor is that the proposal does not change the constitutional provision that the rate of replacement should be one and that the adjustment of benefits should be linked to the wages of active servants. While these provisions still are in the Constitution, the Supreme Federal Court can force the pension funds to implement benefit plans that guarantee it. The problem is that benefit plans with these characteristics probably would have to have rates of contribution much higher than the usual rate in the retirement systems of private and public sector workers. The consequence is that while there would be legal questions about these issues, the pension funds probably will not be implemented.

Secondly, the new system does not change the formula to calculate the retirement benefit for civil servant. The benefit will still be equal to the last wage for those who receive less than the ceiling. The formula for private sector workers tends to generate reduced benefits than the rule valid for civil servants, once it consider all wages received by the worker since July 1994 and also consider the life expectancy at the age of retirement. For two workers who receive less than the ceiling of benefit, employed in private and public sector respectively, the retirement benefit tends to be smaller for the private sector worker. It happens because the wages in the private sector usually increase until certain age and then started to decrease. In the public sector the wages usually increase with the age<sup>56</sup>. As the formula for private sector workers consider a long series of wages, the average wage tends to be smaller than the last wage.

For workers who receive more than the ceiling, under the new rules the difference between the benefits for private and public sector workers can vary. If the private sector worker has received higher wages for the most part of his life, the benefit formula could have no impact since there is a ceiling for benefit. A public sector worker who has received wages higher than the ceiling for most part of his/her period of service also will have his/her benefit limited to the ceiling and in this case there will no difference between private and public sector workers. But if the private sector worker has received wages around the ceiling of benefits, he/she probably will have a retirement benefit smaller than a public sector worker with the same revenue history, since the elements that can produce a reduction in the amount of retirement benefit will be applied to him/her and not to the public sector worker.

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<sup>55</sup> Between 1999 and 2002 more than 5 thousand servants were hired. Between 1995 and 1998 45 thousand servants were hired. Unfortunately these data have some problems accordingly the Ministry of Planning, responsible for the data. Probably the number of servants hired between 1999/2002 is significantly higher than 5 thousand.

<sup>56</sup> Santos, L. A. (2000). pg. 34.

The use of life expectancy in the formula for private sector workers also can play an important role in defining the retirement benefit and it is an element absent from the retirement system of civil servants<sup>57</sup>. This difference in the benefit formula means that an important element of inequity between the systems already will exist, although its impact will be diminished once there will be a reduction in the number of civil servants covered by the new system.

Another difference between the retirement systems of private and public sector workers was introduced by the Constitutional Amendment #20 and still is present in the proposed system. It refers to the eligibility criteria that for civil servants hired after the December 1998. Those servants have to have 35 years of contribution and be 60 years old, if man, and 30 years of contribution and 55 years old, if woman, to get retired. The age criterion is higher than those valid for the private sector workers<sup>58</sup>, and is another difference that has to be addressed to achieve the goal of equity between the systems.

The main problem with the new system proposed is that it only will be mandatory for the civil servants hired after the implementation of pension funds. It means that almost five hundred thousand workers will have their retirements under the actual system. The consequence is that the reduction of the financing gap in the actual system only will start in the long run. In the short run probably there will be an increase in the expenditure of the National Treasury with social security. The Table X shows that with the new system the National Treasury will have to face increasing expenditures in the short run, as well as reduction in the collection of contributions for the actual system. It means that the unbalance already existing could become greater before the system get in a path of sustainability. It is clearly a great negative point in this proposal, since the reduction of the deficit in the retirement system of civil servant that can be achieved in the short run is one of the most important goals of social security reform.

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<sup>57</sup> For more details about the consequences of use all wages since July 1994 and life expectancy in the formula of calculus of retirement benefit of private sector workers, see Ornellas, W., Vieira, S. (1999).

<sup>58</sup> 53 and 48 years for men and women respectively.

**Table X – Consequences for National Treasury of the Proposed Retirement System of Civil Servant**

	Increase in expenditure	Reduction in collection of contributions for the actual system
<i>Celetista</i> worker	? 22% of total wage to retirement system of private sector workers ? Proportional contribution to pension fund for those with wages above the ceiling	? 11% of the total wage from active servant that become retired. <sup>1</sup>
“New” Civil Servant	? Proportional contribution to pension fund for those with wages above the ceiling	? 11% of the difference between the ceiling and the total wage
“Old” Civil Servant		
With option for the new system	? Proportional contribution to pension fund for those with wages above the ceiling	? 11% of the difference between the ceiling and the total wage
Without option for the new system	? No increase in expenditure	? No reduction in revenue

1 – Considering that each *celetista* worker will substitute a retired civil servant

### **3.2. Perspectives for the retirement system of federal civil servants**

As we have seen the new system proposed does not solve one of the most important problem of the actual system, the huge financial gap between contributions and expenditures. Although the new system make a movement towards a more uniform rules to be applied to private and public sector workers, some important differences will still exists. If the government wants to reduce the deficit in the retirement system of civil servants, it is not enough design and implement a new system only for new civil servants. Some changes must be implemented in the actual system with focus in reduction of expenditures and increase in the revenues. These changes also have to address the problem of different rules applied to private and public sector workers.

The questions discussed before suggests that a change in the formula of calculus of retirement benefit of civil servant could be an important improvement in the system. If the same formula applicable to private sector workers would be applied to civil servants the two objectives above mentioned would simultaneously achieved. The use of life expectancy and all wages received since July of 1994, embedded in the formula to calculate the retirement benefit, would equalize an important rule in the two systems. It also would introduce some elements that could help the system to achieve an actuarial balance in the long run through some reduction in expenses. In the short run it would reduce the rate of replacement reducing the growth of the deficit.

Another measure that can have an immediate effect on the financial gap is the collection of contribution on retirement benefits. It is a polemic issue that have suffered strongly opposition in the National Congress. One of the arguments against this collection is that the amount that would be collected would not eliminate the deficit in the system. In 2000 for example, a collection of 11% on the retirement benefits paid by the National Treasury could raise 1,8 billion of Reais, what represents 11% of the financial gap in the retirement system of civil servants. The point is that the introduction of contribution on retirement benefits would immediately reduce the expenditures, an strong necessity, would reduce the huge transference of resources from the society to a relatively small group of civil servants and would eliminate an strong incentive to retirement in the public sector. Some alternatives to make this proposal politically feasible would be the introduction of contribution only for servants that were transferred from the CLT Regime to the Statutory Regime or only for servants that would be retired after the establishment of this new contribution. Of course, both of these alternatives would imply a reduction on the benefits provided by the collection on all retired servants.

Another important measure to reduce the fiscal and actuarial imbalance in the system is the adoption of an age limit to retirement. This kind of limit is important due to the growing life expectancy of Brazilians and the actual low age of retirement. The Constitutional Amendment #20 introduced the same limit for workers in public and private sector that was working at the time of its promulgation. For new hired workers the limit is different. Unify these age limits, and apply it immediately or even with a transition rule for actual workers will be an important measure to achieve some fiscal and actuarial balance in the system.

Even after the reforms introduced in the nineties the retirement system of civil servants is facing huge problems regarding its sustainability in the medium run. The fiscal impacts of this system will force the government, and the society, to change it. The changes will bring some costs that would be shared between retired servants, Brazilian society and active civil servants. In Brazilian legal framework, it is extremely difficult to change benefits already granted, due to what is called “acquired rights”. It means that a law can not change, suspend or cancel a right for persons that already have implemented conditions to acquire this right before the new law. Due to this principle change in benefits already granted are difficult and improbable. The Brazilian society is already paying he costs of an unbalanced system and is exactly because these costs are increasingly high that the changes will have to be implemented. As a consequence the burden of changes that will occur will have to be supported mainly by the active servants.

These changes can have more or less profound consequences for civil servants. It will depend on the time the change will be implemented. If nothing will be done in the short run, the deficits will rise until the point that radical measures will have to be taken. The consequences would be great reductions on future benefits, high increases in rates of contribution, sudden implementation of tighter eligibility criteria or a combination of those measures. To avoid these undesirable consequences changes must be implemented as soon as possible. The system is already functioning with high financial unbalances and as long as we take to implement adjustments the burden to be paid will be higher.

Is important element to keep in mind that even with changes in the system, the financial gap between contributions and payments in the retirement system of civil servants still be present for the next thirty of forty years. What is in discussion is how to make this deficit manageable and reduce its negative effects on the public finances.

Fortunately the elect government has showed its concern regarding the reform of the retirement system of civil servants. Although there is no structured proposal from the new government related to the reform of retirement system of civil servants, some articles in newspapers point out to a proposal focusing in the union of the systems of private and public sector workers, with uniform rules applied to all workers in a two pillar model.

It is an important signal that the some important problems identified in the actual retirement system of civil servant will be addressed in the next administration. If the new government could explain to the society in an undoubtedly and clear way that there are no alternatives than reform the actual retirement system of civil servants, its initial strong political support can lead to important and necessary changes we must have to face.

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