Initiative for Policy Dialogue

**Brazil Country Dialogue on Pension Reform**

**March 30th to April 2nd, 2003**

**Summary Report**

The Initiative for Policy Dialogue, at the invitation of the Council for Economic and Social Development, sent a team to Brazil for a policy dialogue on pension reform. The Council for Economic and Social Development was created by the new Brazilian President, Luiz Ignacio Lula da Sila, as a forum for inclusive policy debate on current national issues. In light of the fiscal targets established by the Federal Government for 2003 (4.25% of GNP primary surplus), the reduction of the pension system deficit has taken on added importance.

The IPD team met with the major governmental actors involved in pension reform. This included the Council for Economic and Social Development, who brought together civil society to formulate a proposal for pension reform; the Secretary of Social Security of the Ministry of Social Security; and members of the House of Representatives Committee on Social Reform. The IPD team also met officials from the Ministry of Finance and from the Institute for Applied Economic Research (IPEA), and held a conference call with the National Bank for Social and Economic Development (BNDES).

The IPD team included Michael Orszag, co-director of the Initiative for Policy Dialogue's Pension Reform and Social Insurance Task Force and head of research at Watson Wyatt; David Lindeman, a principal analyst on pensions at the Organization of Economic Cooperation and Development (OECD) and former Executive Director (1994-97) of the Quadrennial Social Security Advisory Council of the U.S. Government; and Sarah Brooks, Assistant Professor of Political Science at Ohio State University whose work covers the process of pension reform in Argentina, Brazil, Mexico and Uruguay.

The IMF, World Bank, and the government all agree on the need for reform and the necessity to cut costs. The IMF and World Bank are recommending cutbacks, however the framework of how to do so is unclear. The current pensions system in Brazil includes some aspects that are seemingly inappropriately designed, and have resulted in peculiarities and distortions. Nonetheless, the system was originally designed to confront legitimate concerns. Given the complicated incentive structures, the original design led to outcomes that no one would have chosen. For example, pensions are currently tied to the salary a civil servant makes in their final year before retirement. Thus many civil servants receive huge raises right before they retire. The IPD team stressed the need to delineate the goals of the system, and incorporate them into a framework with an appropriate incentive structure. A process without a well-thought out framework could lead to political turmoil or, at best, be politically infeasible.

Four proposals are currently receiving strong support in Brazil: (i) increase the minimal period that a civil servant has to work in the Government in order to take part in the civil servants pension scheme; (ii) increase the minimal age required to retire; (iii) establish a ceiling for the value of the retire benefits paid, and (iv) reduce the value of pensions to 70% of the retire benefit paid to the spouse before his death.

Working from these four starting points the IPD team was able to alert government officials to the necessity of taking further measures in order to achieve the deficit control goal they had in mind. IPD's team showed the government that the measures under consideration to reform civil service pensions would not appreciably reduce the deficit and that further and more dramatic reforms would need to be considered to keep public sector pension spending under control.

The IPD team further drew policymakers attention to the fact that a proposal to increase the income cap in private workers pension regime in Brazil would produce counterproductive income distribution effects and long-run cost effects. After reviewing the projection model of the Department of Social Security and its assumptions, the IPD team provided input to its further development, as well as a number of policy reform ideas for the civil service based on models from the U.S. and other countries.

The conclusions drawn by the World Bank regarding Brazil's discounting assumptions were also discussed and reviewed. Some members of the IPD team feared that the IMF and World Bank are recommending cutbacks without a framework of how to do so. There was discussion about policy options for increasing coverage in order to make the system of public pensions more sustainable. Team member, David Lindeman, discussed with State Finance Ministers transition options for state and municipal pension funds. The feasibility of a U.S.-style Federal Employees Retirement System (FERS) model for these funds was discussed as well as the advantages and disadvantages of integrating public sector employees into the main Brazilian social security system.

An important aspect of sustainable and politically feasible policies is choice for the participants. And a well-designed policy should offer choices between the old plan and the new. President Lula opened the debate by creating the Council for Economic and Social Development to create a process in which all economic stakeholders can participate. IPD was asked to be part of this discussion. President Lula has recently sent a proposal for pension reform to Congress.

IPD will continue to work with Brazil to further contend with the issues and explore new policies. Upcoming issues include Labor and Industrial Policy. We expect to send additional teams to Brazil to work on these issues. This most likely will be culminated in an IPD country dialogue with meetings with Council for Economic and Social Development, the Parliament, and the government.