Wage supplement program for employees with low pay
(qualification)

- Old Benefits, New Program –

A. Context

1. **Changes in income distribution.** As a result of a highly inclusive process of growth, poverty has declined steadily and substantially over the last decade in Brazil. Although estimates vary depending on how you define poverty and vulnerability, there is consensus that about 15% of the population transitioned from vulnerability and poverty to join the new Brazilian middle class.

2. **Role of the labor market.** To a large extent, the profound changes in the distribution of income resulted from parallel changes in the labor market. Almost two thirds of the increase in income of those who joined the so called class C resulted from increases in labor compensation. This increase, in turn, resulted from a sharp growth in both formal employment and wages.

3. **Workers with low qualification.** While recent history has been favorable to all workers, it was particularly favorable to those with low skills. While average earnings grew 1.5% per year, among unskilled workers the compensation increased by 3.5% per year. While the level of formalization of the labor force grew by 1.2 percentage points per year, among those with low qualification the growth was 2.5 percentage points per year. As a result, the country currently has 14 million formal employees with low education, representing 41% of employees with a formal contract in the country.

4. **Repositioning in income distribution.** For low-skilled workers, access to formal employment is an important step in the rise to the new middle class as well as in the maintenance of this achieved middle class status.
5. **Future Challenges.** Not all labor market issues have been resolved. The turnover rate remains extremely high and increasing, while labor productivity remains low and virtually stagnant. Thus, the continuity of this impressive rise of unskilled workers now depends on other factors. In the coming years, the maintenance of the ascension process becomes dependent on the success in reducing turnover and also on significant increases in the productivity of formal jobs.

**B. Wage supplements to low skills workers (qualification).**

1. **International experience.** Today, many developed countries already have some sort of wage supplement for low-skilled workers in the labor market. The most traditionally discussed is the American *Earned Income Tax Credit - EITC*, but similar programs exist in the United Kingdom, Ireland, Netherlands, Belgium, France, Austria, Denmark, Sweden, Finland, Canada, Australia, New Zealand, Singapore\(^1\). Financed with public funds, these programs are characterized by a wage supplement per hour worked, for workers or families of workers with low pay. They represent an additional public benefit to the amount paid by employers. The goal is always to enhance and encourage work, raise incomes of the most vulnerable families and thereby reduce inequalities.

2. **A Brazilian experience already exists.** Such programs exist in Brazil, though not always their purposes are understood and acknowledged. Two programs deserve special mention: the *Abono Salarial* and *Salário-Família*. Despite considerable differences in the design and funding sources of the two programs, both programs have the following characteristics: (i) they provide additional compensation with public funds to employees who were active in a given reference period and (ii) they are basically oriented towards the same group: formal employees with low skills (qualification).

3. **Abono Salarial Today I.** Financed with funds from the *Fundo de Amparo ao Trabalhador – FAT*, the *Abono Salarial* benefit is a minimum wage paid in the subsequent year to employees who worked at least one month with an average monthly salary of up to two minimum wages. But not all employees with a formal contract with a salary that is less than two

\(^1\) At the end of this note, a summary table of the benefits in these countries is presented.
Minimum wages are entitled to receive the benefit. In order to qualify, the employee must, in addition to having worked in the last year, have already worked in the formal sector in over the last 5 years (registration in PIS/PASEP for at least five years). This device excludes the beneficiaries that are very young workers and also informal newcomers to the formal sector. The *Abono Salarial* also excludes employees whose employer is a natural person, in particular domestic workers.

4. **Abono Salarial Today II.** It is noteworthy that the benefit is paid only in the following year and it is not proportional to the number of months worked or to the compensation received. Thus, a worker who has worked only one month in a year (and could even have worked the remaining months in the informal sector) will receive the same benefit that a worker who remained employed throughout the year in the formal sector.

5. **Salário-Família Today.** The social security benefit is financed with funds from the *Instituto Nacional do Seguro Social* - *INSS* to all employees and workers that contributes to the National Social Security System, except domestic employees. Unlike *Abono Salarial*, the benefit is per child, paid monthly and parallel to the job. If the mother and father work and receive a payment that is lower than that stipulated limit, both receive the *Salário-Família* benefit, even if they work in the same company. The amount paid per child is R$ 35 (Reais) for those who receive up to R$ 682.50 and R$ 24.66 for those who receive between R$ 682.51 and R$ 1,025.81. That is, it is equivalent to 3.5% of the salary of those who receive 1 minimum wage and 2.5% of the salary of those who receive between 1 and 1.5 minimum wages. It is noteworthy that retirees and workers beneficiated by social security assistance are also entitled to the benefit.

C. Proposal: unification of subsidies to work.

1. **Unification.** It is not clear the rationality of the current strategy, which uses two instruments with different designs and funding sources to achieve the same goal: to support and encourage the inclusion in the labor market of low-income formal employees (low-skilled workers) and thus, to raise household income and reduce inequality. Therefore, it would be advisable to align the two instruments and to refine their design. In this context, it is proposed to
unify the payment of *Abono Salarial* and *Salário-Família*, since the two instruments aim to support and encourage the inclusion of low-skilled employees (income) in the formal labor market.

2. **Synchronism between the time of work and payment.** Relative to the payment, it is preferable that the *Abono Salarial* benefit is paid monthly, together and in the same way as the *Salário-Família* currently does. The monthly payment has the advantage of greater transparency and clarity to the beneficiary. This payment method allows the employee to easily visualize, incorporate and rely on the grant as part of their monthly salary. The current way of payment of the *Abono Salarial* – in the coming year - does not give the worker the prospect of a gain directly related to his participation in the formal labor market and therefore does not allow him to meet certain needs; nor does it serve the purpose of incentive to work. It may even be the case that in the following year, when they will receive the benefit, the household already has a satisfactory income (some important family member who was unemployed may have found a job) or that the employee has chosen to work in the informal sector, which would, with the proposed new design, result in the loss of the benefit. For these reasons, the synchronism between the payments of the benefit and the realized work will have a direct impact on the level of consumption and food security. In the means that it consists of a salary increase, it also serves as an incentive to join and remain in the formal sector. It is then more effective in fighting poverty and inequality, as well as an incentive to more effective formal work.

3. **Proportionality to work.** The monthly payment for work, simultaneous to the remuneration paid by the employer, would eliminate the current undesirable feature of the *Abono Salarial*: workers with the same salary, but that worked a different amount of months, receive exactly the same benefit. With the proposal, the benefit, to be paid in the worked month, would be proportional to the number of months in which the employee effectively worked.

4. **Decreasing conditionality.** With the current rule, employees that recently entered the formal sector have no right to use the *Abono Salarial*, punishing precisely those workers that start in less favorable positions in the labor market. In this sense, it is proposed the end of the
requirement that the worker should be registered in PIS/PASEP for over 5 years, which will certainly benefit young and less educated workers.

5. **Limits alignment.** The benefits *Abono Salarial* and *Salário-Família* have different wage limits. While the *Abono Salarial* is guaranteed to employees receiving up to 2 minimum wages, the *Salário-Família* is guaranteed to employees who receive up to R$ 1,025.81. The difference in the limits hinders the perception of the similarities between the two programs.

### D. Advantages

1. **Incentives to formal work.** As the wage supplementation is linked to formal employment, this program should serve as an important incentive for the formalization of labor relations.

2. **Reduction of turnover.** The change in the payment system, with the introduction of the timing between the working month and the benefit as well as of the proportionality between the working period and the value of the benefit received act as an incentive to stay in that employment situation, reducing job turnover.

3. **Incentive to youth employment.** The end of the worker's registration conditionality in PIS/PASEP for over 5 years will extend the right of *Abono Salarial* to young people, facilitating their entry into the labor market in more favorable positions.

4. **Rearrangement of what already exists.** The simplicity of the proposal allows a simple rearrangement of existing benefits without constitutional changes.

5. **Low cost, inclusion of many.** The alignment of the limits for entitlement to benefits and the end of the registration requirement in PIS/PASEP for over 5 years represent prompt additional benefits to more than 10 million employees at a cost of approximately R$ 2 billion per year, a cheap alternative to minimum wage adjustments.
6. **Brazil is together with the most developed countries.** Labor incentives mechanisms are recurring in developed countries. Its importance has been reinsured in recent policy reformulations of some countries, like France, which also opted for the change from a single annual payment to payments linked to the months worked, which is equivalent to the approach outlined here.

**E. Disadvantages**

1. **Exclusion of the not so poor.** Programs of this kind are not able to promptly benefit neither the poorest families who are unemployed nor informal workers. Given the Brazilian labor market’s current conditions, it is estimated that 70% of current beneficiaries of these programs are members of the new middle class. However, the end of the 5 years requirement in the PIS/PASEP (to be entitled to the benefit of the *Abono Salarial*) should encourage the entry of more vulnerable workers in the formal sector.

2. **Transitory budget impact.** From a financial point of view, although the program should not require an increase in the flow of provisioned resources, the proposed rearrangement may require advancement in a year in the granting of benefits now associated with the *Abono Salarial*. Thus, in the first year of the program it would be necessary either to double the expenditure on *Abono Salarial* or gradually implement the program, with an increasing share of the benefits being paid in the month in which the employee worked and the other decreasing portion being paid in the subsequent year.

**F. Connection with the Bolsa Família Program**

1. **Abono Salarial compared to Bolsa Família.** The benefits of *Abono Salarial* are not able to compete with that of *Bolsa Família*. That is, *Abono Salarial* is hardly able to compensate for losses of *Bolsa Família* that result from the increase in income and the consequent exclusion from the program.
2. **The need for stronger incentives.** For the *Abono Salarial* to be a strong incentive to enter the labor force, the amount of the benefit would need to be higher. However, rather than making changes to the rules of *Abono Salarial* (which is stated in the Constitution) or to *Salário-Família*, it is easier to create a solution mediated by *Bolsa Família*.

3. **Creating a link between the labor incentive’s instruments and *Bolsa Família*.** The best way to connect the *Abono Salarial* and *Salário-Família* is to create a provisional measure to this proposal: the inclusion - in the *Bolsa Família* Program – of a financial incentive to engage in a formal job.

4. **Advances in the *Bolsa Família* Program.** This provisional measure shall have two components: (i) to increase the per capita household benefit of the *Bolsa Família* for those who find formal employment; (ii) to ensure a basic benefit for children or dependents for a period of 30 months, whatever the level of family income may be.

5. **Advantages.** The first component ensures that more families will remain in the *Bolsa Família* even after their entry or return to formal work. The second component offers guarantees to the family that they will not leave the program after joining the formal market, which mitigates the risk of not being able to quickly return to the *Bolsa Família* in the case of a setback. In fact, the family does not even leave the program! In this sense, the second component brings an improvement over the existing return policy.

6. **References.** A benchmarking for the incentive to entry in the formal labor market for beneficiaries of cash transfer programs is the French RSA. RSA corresponds to a redesign of the old RMI- Minimum Income Insertion, attaching to it the component of incentive to work.