On the Successes and Challenges of Building a Generous and Effective Social Protection System in Brazil

ILO/IZA Conference “Assessing the Effects of Labour Market Reforms – A Global Perspective“

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A. Progress

B. The Brazilian Programs

C. The Need for Continuity

D. The Side Effects

E. The Design Problems

F. The Need for Redesign
A. Progress

The Brazilian Progress

The Brazilian Programs

C. The Need for Continuity

D. The Side Effects

E. The Design Problems

F. The Need for Redesign

Brazilian progress: HDI by municipality
Brazil: 2010

Legend
- 0.800 a 1
- 0.700 a 0.799
- 0.600 a 0.699
- 0.500 a 0.599
- 0.000 a 0.499

Source: SAE/PR, based on Demographic Census of 2000 and 2010 and HDI as calculated by the UNDP, Human Development Report.
A. The Brazilian Progress

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F. The Need for Redesign
A. Progress

Evolution of the Extreme Poverty in Brazil

Reduction in extreme poverty 4 times faster than required by the MDG

MDG met 10 years in advance
A. Progress

Evolution of the Degree of Income Inequality in Brazil: 1976-2014
A. Progress

Average annual growth rates in labor and nonlabor income by tenths of the distribution: Brazil, 2001-14

Labor Income
Nonlabor Income
Improvement in Social Security Benefits

-1,0% 0,0% 1,0% 2,0% 3,0% 4,0% 5,0% 6,0% 7,0% 8,0%
First Second Third Fourth Fifth Sixth Seventh Eighth Nineth Tenth

poorest richest
A. Progress

Evolution of the Main Brazilian Labor Market Indicators II

- **Average Earnings**: R$1,731
- **Unemployment Rate**: 9.0%
  - Real wage increase 44% in 10 years
  - Unemployment rate declined almost two percentage points in 10 years
  - R$1,199

**In 1994**: Unemployment rate was 9.0%

**In 2015**: Unemployment rate decreased to 7.0%
A. Progress

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Evolution of the Main Brazilian Labor Market Indicators I

Minimum wage (R$ of 2015)

- Real minimum wage doubled in 20 years
- Degree of formalization increased 10 percentage points

41% to 51%
B. Programs

Bolsa Família:

✓ Income transfer program for extremely poor families.
✓ Conditional on being (“declaring”) extremely poor and complying with basic education and health related actions.
✓ **If** perfectly targeted, it would transfer enough income to ensure the per capita income of all Brazilian families were above the extreme poverty line.
✓ It is a generous program. **Average** benefit equals two minimum wages per family per year;
✓ It benefits 14 million families (≈25%), even though, only 3 million are expected to be extremely poor, before accounting for the benefits of the Program.
B. Programs

**Abono Salarial:**

- Income transfer program for formal employees with earnings below two minimum wages.
- Conditional on having worked at the formal sector at first, at least five years ago. New formal employees do not receive the benefit.
- The benefit equals one minimum wage per year, representing a 8% increase in earnings for those working the entire year for a minimum wage.
- It is, however, paid in the subsequent year, not at the end of each worked month.
- It is a very generous program. Traditionally, a person working just a month in a year was entitled to receive the full benefit. The generosity is changing to proportionality and a minimum of six month required for entitlement.
Salário Família:

- Income transfer program for formal employees with earnings below 1.5 minimum wages.
- The benefit is close to 3% of the minimum wage for workers at the minimum wage and smaller for workers receiving above the minimum.
- It is paid by the end of each worked month.
- As the “Abono Salarial” it benefits more than 20 million workers (almost ½ of the formal employees, and ¼ of the total Brazilian labor force).
- The benefit is per child less than 14 years old and requires the child to comply with some public educational and health compulsory services.
B. Programs

**Fundo de Garantia por Tempo de Serviço- FGTS:**

- Compulsory monthly savings equivalent to 8% of earnings for formal workers.
- If formal workers are fired, without a just cause, employers have to pay a penalty equal to 50% of the fund the worker has accumulated during the current job spell.
- Out of this 50% penalty, 40 percentage points goes to the worker and 10 percentage points to the government.
- Upon being fired, without a just cause, workers have the option of withdrawing their entire fund.
- Interest rates paid on these savings are fixed well below market values. They are, at times, even fixed below inflation.
A. The Brazilian Progress

B. The Brazilian Programs

Seguro Desemprego:

✓ Unemployment insurance: income transfer to formal workers fired, without a just cause.

✓ Beneficiaries: workers fired, without a just cause, that must
  ✓ 1st time: have worked as formal employees for at least 12 months in the previous 18 months.
  ✓ 2nd time: have worked as formal employees for at least 9 months in the previous 12 months.
  ✓ Others: have worked as formal employees for at least 6 months in the previous 6 months.

✓ There must be an interval of 16 months between consecutive benefits.
B. Programs

**Seguro Desemprego:**

- The value of the monthly benefit is of at least one minimum wage.
- The value of the benefit increases at a diminishing rate with the three months prior being fired average earnings.
- For workers with average earnings above 1,75 of the minimum wage the benefit is fixed.
- Number of monthly benefits (3 to 5) depends on employment duration.
- Despite operating with unemployment rates well below 10% and at least 40% of informality, the Brazilian unemployment insurance benefits 10% of the labor force every year. A consequence of very high turnover rates.
C. Need for Continuity

Income Inequality in High and Middle Income Countries: 2012

- Inequality remains very high
C. Need for Continuity

Distribution of Brazilian municipalities and countries of the World according to HDI, 2010

- Inequality remains very high

Source: SAE/PR, based on Demographic Census 2000 and 2010 and HDI as calculated by the UNDP, Human Development Report
D. Side Effects

Evolution of the Brazilian Primary Federal Expenditures as a Percentage of GDP: 2002-2014

Federal Primary Expenditures are increasing 0.4 percentage points per year.

Severe Fiscal Imbalance
D. Side Effects

Evolution of Turnover Rates among Brazilian Formal Employees: 2003-2015

- Low wage (≤2MW) workers
- Excess Turnover
- All workers

In 2003, the turnover rate for low wage workers was around 55%. It increased steadily until 2008, reaching a peak of approximately 70%, and then decreased sharply to around 60% by 2015. For all workers, the turnover rate was consistently lower, increasing from 35% in 2003 to around 40% in 2015.
D. Side Effects

Evolution of the Brazilian labor force participation rate among men aged 25 to 29 years-old, by their educational level: 1992-2014

Generating Persistent Poverty? Labor Marker Difficult in Absorbing Very Low-Skilled Youth
D. Side Effects

The Evolution of the Average Labor Productivity
Selected countries: 1950-2011

Very Sluggish Productivity Growth

Source: SAE/PR based on the Penn World Tables.
Labor productivity as GDP/worker (Real GDP at constant 2005 national prices).
D. Side Effects

Ratio between labor productivity in 1980 and 2011

Labor Productivity in 2011 (US$ (2005) per year per worker)

Labor Productivity in 1980 (US$ (2005) per year per worker)

Korea

China

Brazil

Very Sluggish Productivity Growth

Source: SAES/PR based on the Penn World Tables.
Labor productivity as GDP/worker (Real GDP at constant 2005 national prices).
The Evolution of Labor Productivity and Real Average Earnings in Brazil: 1996-2011

Imbalance or Alignment Between Labor Productivity and Labor Earnings?
E. Design Problems

1. Poor Targeting;
2. Excess turnover;
3. Reduced Incentives to work;
4. Incentives to informality;
5. Severe public finance imbalances. Treats to sustainability;
6. Questionable equilibrium between growth in earnings and productivity.
E. Design Problems

Inclusion and Exclusion Errors Associated with the Current "Bolsa Família" Program Targeting Mechanisms

"Bolsa Família" Targeting System based on reported income has very serious flaws
1. The wage of low-skilled workers in the formal sector is a decisive factor determining the income of low middle class families. It is also a factor that discourages their participation in the labor market.

2. Turnover is particularly high among the low-skilled workers. Among them it represents 84% of quits, 80% of layoffs, even though they represent only 60% of the total formal workers.

3. What is the best instrument for improving the income of this group of low-skilled workers?
F. Redesign

Need to ensure:

1. Greater solidarity;
2. Incentives to work, economic autonomy, self-reliance and greater proactivity (protagonism);
3. Incentives for formalization;
4. Incentives for more stable labor relation;
5. Incentives for increases in labor productivity;
6. Responsible, balanced and sustainable public funding and spending;
7. Equilibrium between growth in earnings and productivity.
Five complementary strategies for designing policies aimed to improve the earnings of low-skilled workers

- Raising the demand for low-skilled workers (e.g.: workfare, PAC, PAA)
- Investments to improve the quality of jobs for low-skilled workers; improvements in the quality of the available opportunities.
- Professional training of these workers; preparing them to take advantage of the available opportunities.
- Encouraging better work contracts, minimum wage increases and enforcement of labor legislation
- Subsidizing earnings of low-skilled workers (e.g.: Family Allowance, and “Abono Salarial”)

Should promote high earnings by increasing the relative scarcity of workers and by promoting growth in labor productivity

Promote higher earnings by follow this growth (yet they don’t necessarily affect productivity - their isolated use may have limited effectiveness)
Possibilities for improving the existing policies aimed to increase productivity earnings and income security of low-skilled formal workers

Progress in two fronts has been particularly limited over the last decade:

i) Access of *low-skill employed workers* to high-quality professional training.

ii) *Consolidation and improvements* in the design of the (generous but not very effective) already available subsidies to low-skilled formal workers (“Abono Salarial” and “Salário Família”).

iii) *Consolidation and improvements* in the design of the income security system (“Bolsa Família”, “Seguro Desemprego” and “FGTS”)

F. The Need for Redesign
Consolidating “Abono Salarial” with “Salário Família”

A. **Opportunity**: two instruments – with different design and different funding sources – to reach the same goal: subsiding the low-skilled formal employees.

Obs. I: Significant progress in efficacy could be achieved by consolidating and optimization of existing resources, hence, without increasing public spending.

Obs. II: Feasible alternative to raises in the real value of the minimum wage.

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F. Redesign

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Consolidating “Abono Salarial” with “Salário Família”

B. Disadvantages of the “Abono Salarial” Design:
✓ Benefits are only paid in the subsequent year.
✓ Benefits are not proportional to the number of months worked.
✓ Benefits are not decreasing with earnings.
✓ Design excludes young and informal workers who have just entered the formal sector (since beneficiaries are required to be registered for at least five years in the formal sector (PIS-PASEP Fund)).
F. Redesign

Consolidating “Abono Salarial” with “Salário Família”

C. Solutions (learning from the “Salário Família” Design):

- Payment by the worked month, per worked month, to all low-pay formal workers;
- Value of benefits inversely related to the level of earnings;
- Benefits paid by employers from tax and other social contribution deductions.
D. Disadvantages of the “Salário Família” Design:

- Irrelevance conditionalities: burden on employers and considerable difficulties for monitoring with no advantages for children’s development.
- The design and implementation of a good system for monitoring and inspecting payments made by employers.
- Differences in benefits between public servants and non-government workers.
- The value of “Salário Família” benefits and the wage range to which it applies are defined in absolute terms, without a clear indexation rule.
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Consolidating “Abono Salarial” with “Salário Família”

E. Solutions:

✓ The elimination of all conditionalities;
✓ Unification of the rules for public and private sector workers;
✓ Specify the value of benefit as inversely proportional to earnings.
F. Common challenges:

- Should the criteria for defining the target population and benefit values be indexed to the minimum wage ("Abono Salarial" today)?
- Or should it be non-indexed as it is currently done in the case of the "Salário Família"?
- What should be the procedure for adjusting the nominal value of the benefits? Should it be indexed to the National CPI or remained unindexed?
- Importance of improving the monitoring system of the benefit payments by employers (quick implementation of the new DPS).
G. Advantages of the consolidation

- Clearer perception by workers that both benefits are actually incentives to work (with payment by the month worked, per month worked). It enlarges incentives to work.
- It pass to benefit workers at the moment they need the most (months in which their payment are the smallest). It improves income security.
- It provides extra incentives for labor formalization, since only formal employees are entitled to receive the benefit.
- Alternative to increases in the real value of the minimum wage
F. Redesign

Consolidating “Abono Salarial” with “Salário Família”

H. Limitations

☑️ It does not benefit the poorest families, made mostly by unemployed and informal workers. Most beneficiaries of the program already belong to the lower middle class.

☑️ Need to be integrated with “Bolsa Família” to ensure incentives to work, incentives to formalization and reduction in turnover.

☑️ From a public finance point of view, although the program should not require an increase in public expenditure, the proposed rearrangement does involve anticipating payments of “Abono Salarial” benefits.
H. Limitations

- Hence, in the program first year either it would be necessary to double “Abono Salarial” spending or the program implementation is going to be gradual.
- A gradual implementation will undermine many of the advantages of the consolidation. In particular, the perception and visibility of the unification (and hence its impact on the behavior and well-being of workers) will be undermined.
- Any effective consolidation would require a series of additional minor adjustments.
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