Brazil: Economic Implications of the Pension Reform Approval

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Overview

The pension reform bill was approved by Congress on October 22 and enacted on November 12. The main changes of the pension regime include changing the contribution amount, creating a minimum length of contribution time and introducing a minimum age at which pensions are awarded.

Among the factors that probably contributed to the approval of the pension reform bill were: 1) decreased political turmoil; 2) increased public support for pension reform; 3) increased government concessions to congressmen; 4) a rise in concerns regarding the fiscal condition of subnational governments.

The approved pension reform could have two positive implications: 1) an improvement in the fiscal balance and 2) an increase in private investment.

The approval of the pension reform could open the way for future reforms as the government has demonstrated its ability to push through significant legislation. The administration may explore tax reform, privatization of some publicly owned companies and administrative reform in the short-to-medium term.

1. Overview of the Pension Reform

The pension reform bill was approved by Congress on October 22 and enacted on November 12. The main changes of the pension regime include changing the contribution amount, creating a minimum length of contribution time and introducing a minimum age at which pensions are awarded (Chart 1).

Previous Brazilian administrations have tried to reform the pension system, most recently President Temer introduced his proposal to Congress at the end of 2016, but political turmoil, mainly due to corruption scandals, made it difficult for the proposal to gain support from Congress. This year, President Bolsonaro introduced his proposal to Congress and after 8 months of deliberation, the bill was approved. Among the factors that probably contributed to the approval of the pension reform bill were: 1) decreased political turmoil (the corruption scandals that plagued the previous administration decreased under the new administration, allowing the government and Congress to focus on the pension reform); 2) increased public support for pension reform (as a result of an increase in media coverage that led to an increase in awareness of Brazil's weak fiscal condition and the potential risks); 3) increased government concessions to congressmen (as lawmakers demanded something in return for their vote and made changes to the original proposal that resulted in a less stringent pension reform with about 70% of the fiscal savings originally envisioned); 4) a rise in concerns regarding the fiscal condition of subnational governments (as some states and municipalities have requested financial assistance from the federal government to address high levels of debt).

Chart 1: Overview of the Pension Reform

	Private sector		Public sector [1]	
	Previous Regime	**Recently Approved Regime**	**Previous Regime**	**Recently Approved Regime**
Contribution amount (percentage of employee's monthly salary)	- Progressive contribution at 8.0%, 9.0% or 11.0% depending on monthly salary (3 salary ranges)	- Progressive contribution at 7.5%, 9.0%, 12.0% or 14.0% depending on monthly salary (4 salary ranges)	11.0%	- Progressive contribution at 7.5%, 9.0%, 12.0%, 14.0%, 14.5%, 16.5%,19.0%, 22.0% depending on monthly salary (8 salary ranges)
Minimum length of contribution time	- Women: 15 years - Men: 15 years	- Women: No change - Men: 20 years	- Women: 15 years - Men: 15 years	- Women: 20 years - Men: 20 years
Minimum age at which pensions are awarded	- Does not exist	- Women: 62 years - Men: 65 years	(Same as private sector)	(Same as private sector)
Monthly pension benefit that an employee is entitled to [2]	- It is calculated as the average of the 80% highest monthly salaries earned by the employee during contribution time - Maximum amount: R$ 5,839.5	- It is calculated as the average of all monthly salaries earned by the employee multiplied by 60% under minimun length of contribution - The pencentage of pension benefit rises by 2 percentage points for each additional year of contribution - Maximum amount: R$ 5,839.5	(Same as private sector)	(Same as private sector)

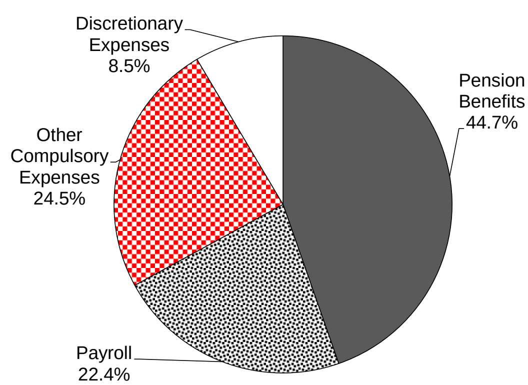
Note 1: The public sector pension regime covers about 1.5 million of beneficiaries and disburses about 4% of GDP in pensions. This is high if it is compared to the private pension regime that covers about 30 million of beneficiaries and disburses about 7% of GDP in pensions. (Estimates done by the IMF in 2015).
2: Minimum age and length of contribution are required.
Source: Ministry of Economy, MUFG Bank Economic Research Office

2. Implications for Brazil's Economy

The approved pension reform bill could have two positive economic implications: 1) an improvement in the fiscal balance and 2) an increase in private investment due to improved market confidence that the government is able to implement important policy changes.

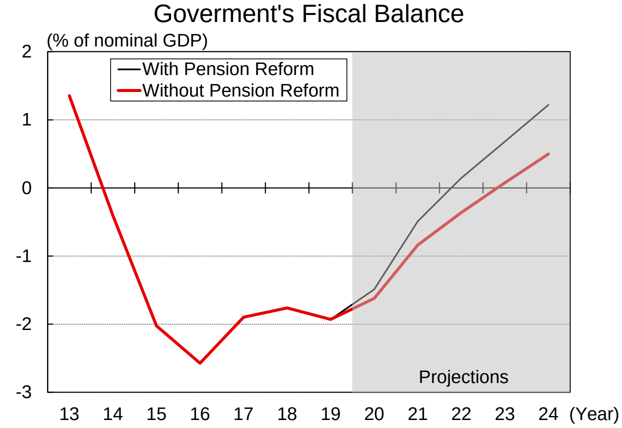
Currently, Brazil's fiscal condition is weak, with central government expenses growing more rapidly than revenues, mainly due to pension benefits representing 44.7% of the central government's expenses (Chart 2). While future increases in expenses are restricted by the 20 year spending cap[1], Brazil needs to find additional cost savings or increased revenue to put its fiscal condition on a more sustainable path. The pension reform bill will help to improve Brazil's fiscal condition as it is estimated to have savings of about 800 Billion Reais (11.7% of nominal GDP in 2018) over a 10 year period (Chart 3)[2].

Chart 2: Share of Central Government's Expenses, 12 month as of September 2019



Source: National Treasury, MUFG Economic Research Office

Chart 3: Effect of Pension Reform on Central Goverment's Fiscal Balance



Source: Ministry of Economy, MUFG Economic Research Office

3. Next reforms

The approval of the pension reform could open the way for future reforms as the government has demonstrated its ability to push through significant legislation. The administration may explore tax reform, privatization of some publicly owned companies and administrative reform in the short-to-medium term. Bolsonaro's government approval rating (while not particularly high) has remained more or less constant from January to November (Chart 4), with polls showing he is doing a good job

[1] The spending cap was approved by Congress in 2016 and limits public spending increases with the increases in inflation.

[2] The fiscal balance projections without pension reform took into account the following:

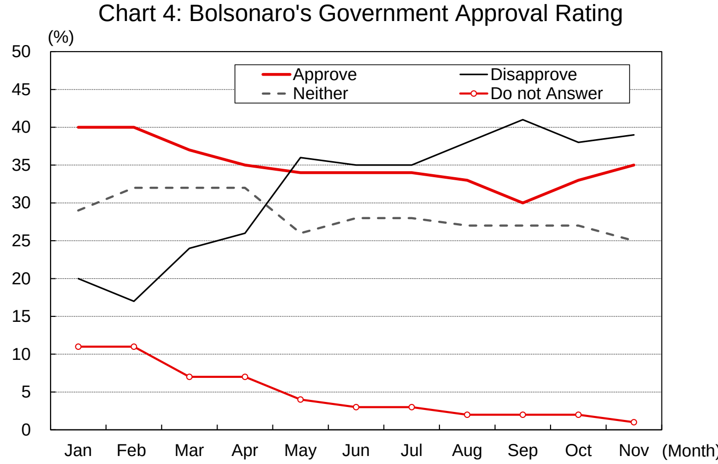
1) Revenues and expenses from 2020 to 2022 were taken from the 2020 federal budget.
2) Revenues from 2023 to 2024 were calculated using the revenues' average percentage growth from 2017 to 2022.
3) Expenses from 2023 to 2024 were calculated using the inflation growth projection provided by the International Monetary Fund (IMF).
4) IMF projections for Nominal GDP were also used in this calculation.

The fiscal balance projections with pension reform took into account the following:

1) Revenues and expenses without pension reform were assumed as the base scenario and introduced the fiscal savings from the pension reform as an addition to the fiscal balance.
2) The total fiscal savings (800 Billion Reais) were distributed over a 10 year period following the percentage distribution over 10 years of the original proposal presented by the Ministry of Economy.

decreasing corruption and improving the economic situation. This factor could positively influence both the government and Congress's agenda regarding important reforms. Currently, there is a scenario where tax reform is more achievable than privatizations as 1) Congress has already started working on its own version of tax reform, which means it is not only an important priority for Bolsonaro's administration, but also for Congress, 2) public support for tax reform is higher than that for privatization[3]. Regarding the administrative reform there are two factors that could help its approval 1) both the government and Congress are looking to continue improving Brazil's fiscal condition and administrative reform could help to decrease government expenses, and 2) the political costs of this reform are limited because the reform's impact will only be seen in the medium-to-long term.

Chart 4: Bolsonaro's Government Approval Rating



Source: XP Investimentos, MUFG Economic Research Office

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[3] "Pesquisa XP com a População", XP Investimentos (November 2019).