27402

SOCIAL DEVELOPMENT NOTES

ENVIRONMENTALLY AND SOCIALLY SUSTAINABLE DEVELOPMENT NETWORK

Note No. 52 **March 2001**

Enhancing Economic Reforms through Social Development: Brazil State Pension Systems Reform LIL

Social Development Best Practice Elements

- Analysis of adverse impacts of the project on the poor
- Institutionalized mechanisms for participation and consensus building within the government
- Ongoing monitoring and evaluation of social development outcomes by the government and community

Brazil is in the throes of tackling its crippled fiscal system. Serious problems exist at both the federal and state levels. The fiscal situation in Brazil's 26 states is under inordinate strain due to the country's enormous pension obligations. These constitute a large and growing component of each state's debt and consume 30 percent to 50 percent of revenues in some states.

The Brazil State Pension Systems Reform Project was aimed at diagnosing the problems in the pension system. The project uses important social development practices, including involving stakeholders, nurturing internal champions, disaggregating data by social groups, and monitoring social impact.

The gravity of Brazil's fiscal problem is illustrated by the ratio of pension expenditures to salaries of civil servants. In the states of Minas Gerais, Rio de Janeiro, and Rio Grande do Sul, this ratio ranges from 50 percent to 120 percent. Retiring pension debt could cost billions of dollars. Strategically, helping the states to address technically the pension debt may be one of the most difficult but necessary policy actions. Reducing the fiscal burden on the states also will indirectly reduce poverty by freeing resources for poverty reduction programs.

Resolving the pension crisis in Brazil has been neither straightforward nor technically easy. The World Bank provided technical assistance via diagnostic tools that assessed the impacts of current pensions at the state level. The analysis identified likely impacts various pension reform models might have on different social groups, including the poor. The project was realistic in scope. It was intended only to equip the states technically to address pension reform and to assist in setting up stakeholder discussion groups to openly examine and debate the merits of various pension reform proposals.

This project was recognized as Best Practice in Social Development by the Social Development Family in June 2000 and received an award for Excellence in Quality at Entry from the Quality Assurance Group (QAG). The task team leader was Chris Parel. This best practice note was prepared by Kathleen Kuehnast.

The government allowed the testing of these diagnostic tools on the social security system. In the end, such technical assistance could achieve only part of the reform. The critical component was building internal government support for constitutional reforms of the pension system.

Creating the Capacity for Learning, Trust, and Reform

Capacity building and technical assistance are critical to redesign a pension program. Equally important is consensus building and strengthening cohesion and cooperation among key stakeholders. The project demonstrates how Bank cooperation with governmental departments can help develop champions and build stakeholder support for institutional and political reform.

The Government of Brazil and the Bank agreed that resolving the pension crisis was an essential step toward the Brazilian states' achieving fiscal stability, since pension obligations constitute a large and growing component of state debt. In December 1997, debt was 13 percent of GDP and 38 percent of total government debt. Although there was consensus about the nature of the problem, the solution was less clear.

Identifying a reform champion in a governmental department proved somewhat difficult since the Ministry of Social Security was wary of Bank involvement and concerned that the Bank would impose its own solution on the country. Nevertheless, the ministry gave the Bank team the challenge of demonstrating the usefulness of new data collection and modeling techniques by first testing them on the social security system.

The Bank used the opportunity to demonstrate to the ministry how comparisons and forecasting could provide the government with tools to create viable solutions for reforms. Bringing more stakeholders into the process proved critical to long-term reform. In April 1998, the Ministries of Finance, Social Security, and Administrative Reforms hosted a seminar for their state counterparts, in which the Bank team presented the results from the brief study. The seminar emphasized the importance of forecasting tools in formulating alternative solutions. State ministers found the results and new information helpful and hopeful. Involving stakeholders in consensus-building was critical for ownership of the reform process to commence.

The resulting Learning and Innovation Loan (LIL) funded two stages of the project. First, it assisted the federal ministry to gain the capacity to undertake the data collection and modeling necessary to analyze the problems. To achieve this, the government set up the Department of Pensions for States and Municipalities. Because it had the technical expertise, the ministry was perceived as the credible leader on the pension issue. This led to the second phase: to help the states build local capacity to address pension reform issues.

The process of involving both state and federal stakeholders proved successful, since the two constituencies were able to reach their own conclusions about the extent of the pension problem and the liabilities. Further analysis revealed that the subsidy for government employees' pensions was larger than for the rest of the social security system. Even though the Ministry of Social Security was responsible for most of the pension system, at the national level no single entity was responsible for the government employee pension system. Government officials quickly realized that existing options and models failed to address these deeper structural problems.

In addressing the gap between government employees' pension funds and those of all other workers, it became evident that the next major barrier toward pension reform was political. To change the pension system, constitutional reform was required. Subsequent defeat of a constitutional reform component dealing with reform of age/eligibility demonstrated that pensions are politically sensitive. Thus, constitutional reform will be a laborious process—one that is opposed by the powerful civil service workers' unions.

Building consensus for pension reforms in Brazil is underway. The Bank's report on pension reform will be circulated throughout the states, in the media, and on the internet to build awareness of the need for constitutional reform and to create popular support for it. Public workshops and stakeholder meetings continue to be key components to build the coalitions for change necessary to implement pension reform.

"Social Development Notes" are published informally by the Social Development Family in the Environmentally and Socially Sustainable Development Network of the World Bank. For additional copies, contact Social Development Publications, World Bank, 1818 H Street, NW, MSN MC5-507, Washington, DC 20433, USA, Fax: 202-522-3247, E-mail: sdpublications@worldbank.org.

Printed on Recycled Paper