The weight of the minimum wage

Solange Monteiro

ONE OF THE POINTS THAT generates the most controversy about retaining the current policy for readjusting the minimum wage is the pressure the policy may bring to bear on government accounts. The problem is that increases in the minimum wage above actual inflation are carried over to pensions and other welfare benefits. This generosity may be beyond the capacity of the public budget, which in coming years will have to bear a substantial increase in the number of elderly in proportion to the economically active population. “Social security is what I call our Greek side,” says Fabio Giambiagi, economist at the National Development Bank (BNDES). “We have a fiscal system that, even though faulty in recent years, has a good Fiscal Responsibility Law; spending on personnel is falling as a proportion of GDP; and there are other positive factors. But our social security system is in general very generous and has true aberrations, such as women retiring at 52.”

The 1988 Constitution established that pensions and other benefits should be adjusted to increases in the minimum wage. Today, there are 26.6 million retirees, who accounted for pension payments of R$235 billion in 2013; 65% of them receive a minimum wage. Other welfare benefits include salary bonuses for those who earn up to double the minimum wage, death benefits, and unemployment insurance; these payments totaled R$118 billion in 2013. “Considering that the number of retirees increases by 4% a year and assuming annual GDP growth of 2.5%, with the current rule, social security payments would rise by 8.5% a year,” Giambiagi says. “If we add the impact on other welfare benefits, the total increase in payments would be equivalent to 1.2% to 1.3% of GDP.” He explains that though the increase seems small, if it is not interrupted, it will leave a disastrous legacy for future generations.

Not all experts are as pessimistic as Giambiagi. Economist Denise Gentil of the Institute of Economics of The Federal University of Rio de Janeiro (UFRJ) argues that the minimum wage policy and the rules of the pension system are fine. “I’m not saying there are no problems with its continuation, but there is no need to adjust the fiscal policy,” she says. “Our problem is the external financing constraint and low industrial growth.” Her calculations show that in recent years, contrary to the idea of a negative impact on public finances, social security revenues exceeded benefits: “For the past eight years, average growth of social security revenues was 8.7% a year while growth of social security benefits was 6.3%.”

Gentil underscores that the current policy cannot be seen as virtuous in itself; it must be accompanied by a program to push up productivity: “What we need is a good industrial policy, without leaving this path, or we risk reversing achievements.” She defends the theory that higher public spending on social security and welfare benefits has a major impact on aggregate demand. “This money is intended for children, the elderly poor, sick people with a high propensity to consume and to fully spend the income they earn,” she says. “Such growth stimulates increased domestic production, which in turn
boosts hiring workers, which will generate more GDP, and more income and tax revenues.”

For Marcelo Abi-Ramia Caetano, economist, Institute of Applied Economic Research (IPEA), financing social security has become an issue not only because of the increasing number of retirees but mainly because social security benefits are increasing faster than the wages of those who pay the social security tax. He advocates a middle way for adjusting social security benefits: calculating initial pensions and benefits based on the minimum wage and then adjusting them according to inflation: “This would be an alternative that would not eliminate but would ease the fiscal cost because it adjusts only the initial benefit, not the flow of new concessions. This would ensure that the benefit does not lose much purchasing power, which could leave poor people vulnerable.” But Caetano insists that any change in the minimum wage policy will work only if there is comprehensive reform of social security. For instance, death benefits ensure an integral pension for the widow without caps, which is not international practice.

Manoel Carlos Pires, IPEA economist, believes the concern about decoupling social security benefits from the minimum wage is a distraction in view of the need for full debate on social security reform generally. This view is supported by Nelson Barbosa, researcher at the Brazilian Institute of Economics (IBRE), who argues that the value of pensions and benefits can continue to track the minimum wage adjustment in line with higher productivity—if rules are revising for granting three benefits: salary bonuses, unemployment insurance, and pensions for death and accident. “With these measures, it would be possible to keep the social security benefits-to-GDP ratio stable and continue increasing the minimum wage above inflation,” he says.

In contrast, Giambiagi believes it is essential to decouple pensions and welfare benefits from the minimum wage. “We can draw a parallel between the social security issue and the environment: trends throughout the world each month may be no different from the previous month, but in 50 years the climate changes can be dramatic. If we do not make adjustments, in 30 years we will leave a disastrous legacy for future generations,” he stresses.

“I’m not saying there are no problems with the continuation of this policy, but there is no need to adjust fiscal policy. Our problem is the external financing constraint and low industrial growth.”

Denise Gentil

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Brazilian Social Security: Revenues and expenditure
(Billions of reais)

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<th>Year</th>
<th>Revenues</th>
<th>Pensions</th>
<th>Death benefits</th>
<th>Wage bonus</th>
<th>Unemployment insurance</th>
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Source: Brazilian Institute of Economics.