

Labor Market, Skills and Productive Inclusion

Refocusing labor programs to benefit job seekers 



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There is an overlapping of programs and the lack of an activation policy

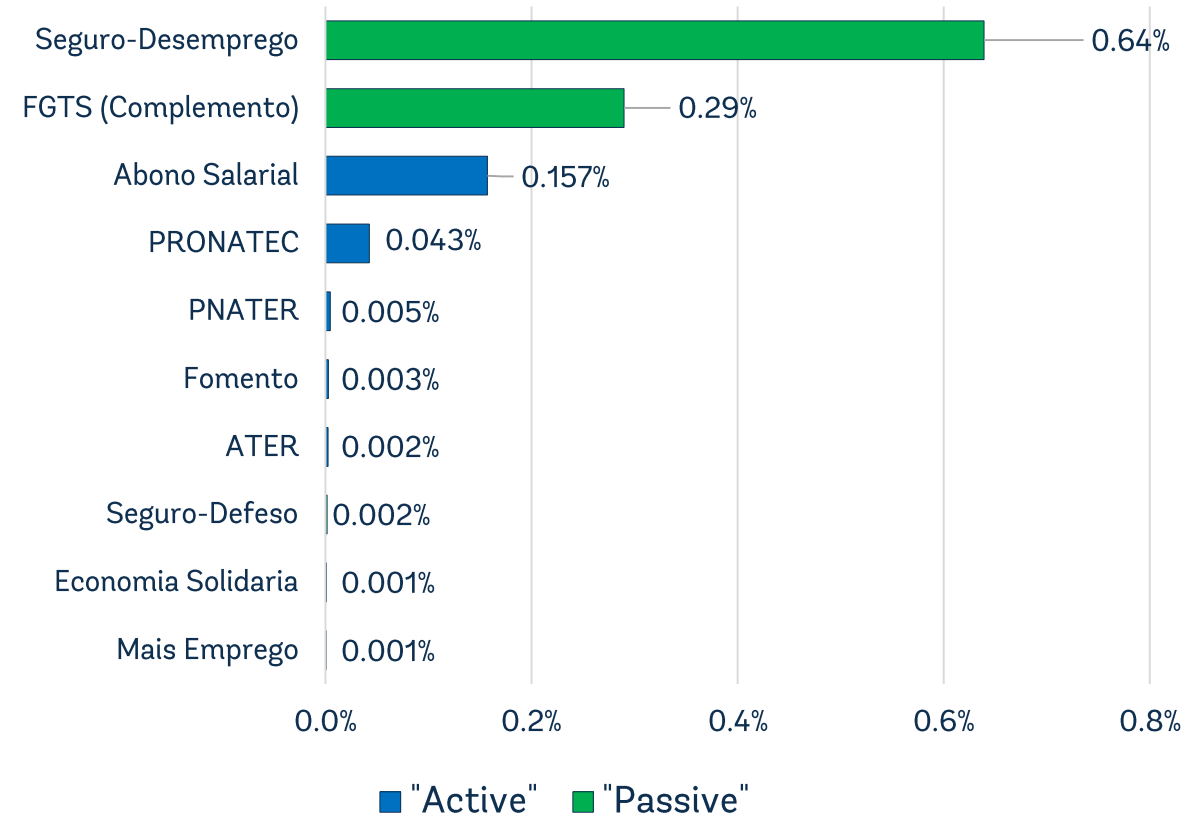
- **Overlapping and uncoordinated unemployment income support programs create perverse incentives that reduce tenure within jobs and extend unemployment spells.**
 - The overlap between Seguro Desemprego, FGTS, and Multas in the event of unemployment results in high replacement rates of the previous wage by all international standards while at the same covering the unemployed workers for a relatively short period of time.
- **An activation policy could contain expenditures on unemployment income support programs and support activation services to assist workers to find their next job. However Brazil currently lacks the capacity and the resources to implement an activation policy.**
 - In OECD countries, unemployment insurance is accompanied by a suite of activation services to support and incentivize workers to find their next job.
 - The obstacle in Brazil is not legislation, but lack of capacity and an chronic under-financing of labor offices in the Sistema Nacional de Emprego (SINE) labor offices.
 - The SINE network is highly decentralized with municipalities co-financing services provided. The federal authorities in the Ministry of Labor (MTE) also have limited tools and resources to financially incentivize outcomes rather than outputs and build capacity at the state level.

I. Key Sectoral Challenges

Spending on labor programs is substantial and fairly regressive

- Brazil's federal budget expenditure on labor market programs was 1.1% of GDP in 2015, lower than OECD avg but higher than LAC peers.
- When mandatory labor programs financed by employers are included, total expenditure rises to 2.8% of GDP, which is above the OECD avg.
- Spending on cash transfers is concentrated on individuals who have recently lost their formal jobs, excluding unemployed youth, long-term unemployed, and recent entrants in the labor market.
- The short duration of unemployment insurance payments reduces resources available to the most vulnerable who are more likely to need a longer time to find their next job.
- The limitation of eligibility for most services and cash programs to the formal sector excludes most of the poor and bottom 40%.

Figure 1: The dominant share of public spending is on income support for people who have lost formal jobs (Brazil top 10 labor programs, 2015, percentage of GDP)



I. Key Sectoral Challenges

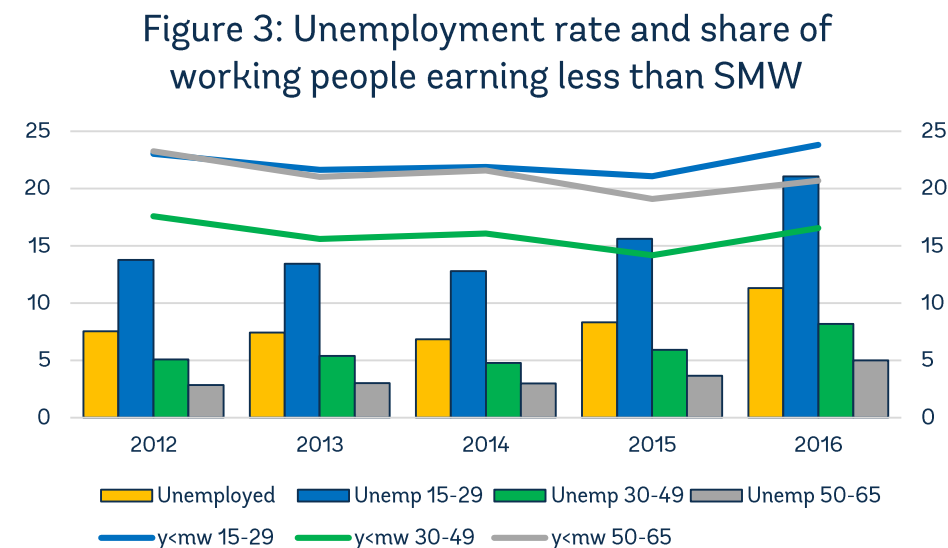
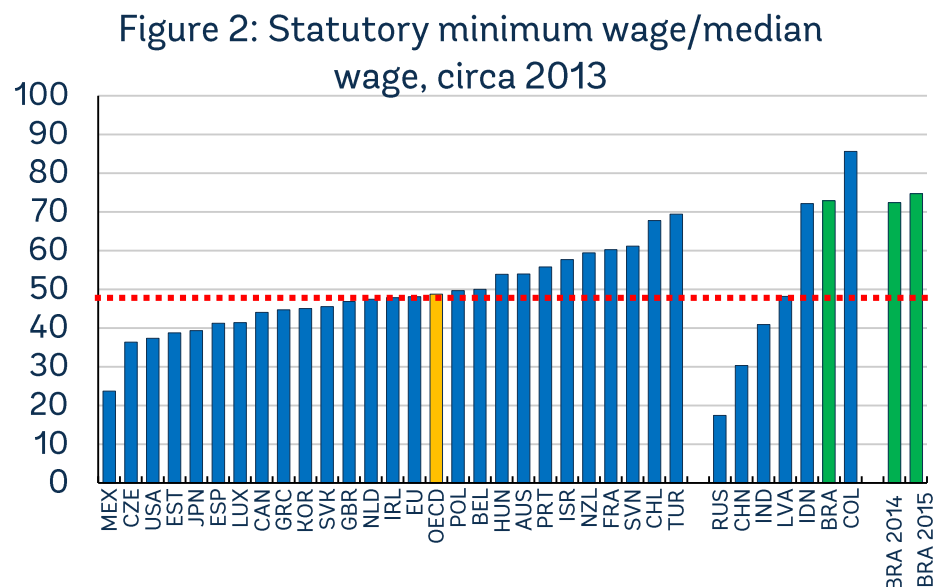
Wage supplements have limited effectiveness

- **Wage supplements have limited effectiveness as income support for the working poor and do not help vulnerable workers enter into jobs.**
 - Among active labor measures, spending is heavily concentrated on wage-top ups, such as Abono Salarial and Salário Família.
 - Neither program performs the key function that wage subsidies need to play:
 - a. They are not targeted to vulnerable workers, such as unemployed youth, long-term unemployed, or recent entrants in the labor market; and
 - b. They do not affect employers' incentives to hire vulnerable workers, which is fundamental in a context where many workers have productivity levels below the minimum wage.
- **While there are some activation programs in Brazil, such as training, job search assistance, and intermediation, they receive only about 4% of total spending on labor market programs.**

I. Key Sectoral Challenges

Cost of formal employment is high

- The minimum wage is high (70% of the median wage) compared to international benchmarks—the minimum wage in OECD countries correspond to 45% to 50% of median wage.
- The high and rising minimum wage combined with statutory social insurance contributions and obligations like the Abono Salarial raise the cost of formal employment—high above the level of marginal productivity of many workers, particularly the youngest.
- Recently, the number of people working for less than the minimum wage has increased.

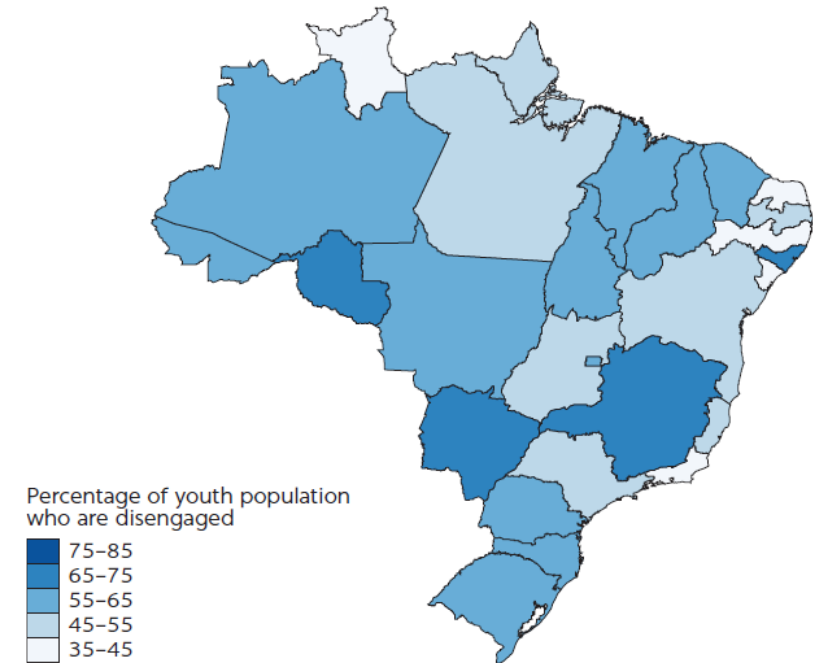


I. Key Sectoral Challenges

So what? Consequences:

- **Perverse incentives that encourage ‘churn’.**
 - Dismissal bonanza, and
 - Firm-specific human capital loss.
- **Higher labor program spending than might be necessary.**
 - Income support with little required re-skilling or job search.
- **Youth economic disengagement in a rapidly ageing country.**
 - Most to gain from intermediation services,
 - ...including “Productive Inclusion”

Figure 4: Youth Economic Engagement Varied Widely Across Brazil in 2015



Source: Estimates based on data from the Pesquisa Nacional por Amostragem de Domicílios (PNAD), 2015.

Note: The map shows the shares of disengaged youth in each state relative to the state's youth population. Disengaged youth are those 15–29 years old who (1) work in the informal sector (including those only working and those also studying); (2) only attend school, but are lagging in learning (with a grade–age gap); or (3) do not work or attend school (that is, are out of school and out of work, regardless of being active or inactive).

I. Key Sectoral Challenges

2017 Labor Reform addressed some of the past challenges

- High degree of judicialization of labor disputes meant that employers faced considerable uncertainty over the true cost of employment
- CLT labor code would override collective bargaining, preventing mutually agreed beneficial shop-floor settlements
- Terms of contracts dictated by CLT code, including hours and schedule of work, break times, vacation, etc.
 - Not adequate for business with intermittent demands (restaurants, retail, etc.)
- Mandatory union fees and fragmentation by professional subgroups allowed the creation of thousands of “token” labor unions at the municipal level, many with no capacity or incentive to represent their constituents in labor disputes.
- Outsourcing was only allowed for intermediary inputs and services, which implied many industrial products could not be competitively produced in the country (electronics for instance).
- Initial results suggest a significant reduction in labor disputes brought to the courts.
- Impact on employment creation less clear: shift towards self-employment, but not obvious whether this is formalization of previously informal jobs or tertiarization of formal jobs to escape high payroll taxes
- So far limited impact on increased collective bargaining

II. Policy Recommendations

Measures to enhance the effects of the 2018 labor code reform

- Several reforms could significantly enhance the functioning of Brazil's labor market and increase the activation and integration of vulnerable groups:
 - Align changes in the minimum wage with future changes in productivity
 - Reform labor market programs to support activation
 - Build capacity for labor activation programs at state level and productive inclusion
- Legislative changes should be accompanied by a better articulation of cash benefits and a net improvement in the quality and financing of labor market services.
- The overall goal is to build capacity and credibility in the delivery of active labor market programs while protecting the fiscal space to finance them.
- In addition: need to address risk of tax arbitrage between self-employment and labor contracts; also time and investment needed to build collective bargaining capacity by both worker unions and employers

Align changes in the minimum wage with the productivity level

- Forging a closer link between the statutory minimum wage at the federal level and the prevailing productivity level in the Brazilian territory.
 - Real minimum wages would not be reduced from current levels, but allowed to rise only to the extent that labor productivity improves
 - This would facilitate the insertion of more vulnerable workers in formal jobs, especially young people.
 - A moderation of the federal minimum wage would allow more wriggle room to adjust statutory wage floor at the state level, given the significant differences in wage and productivity and employer monopsony power between states in Brazil.
 - Tying the minimum wage to improvements in productivity would also make an important contribution to improving the fiscal balance of the social security system and contain the costs of other social benefits indexed to the minimum wage.

II. Policy Recommendations

Reforming labor market programs to support activation

- **Reforming and integrating the Seguro Desemprego and FGTS to improve labor market incentives.**
 - Formal workers have generous unemployment protection. Combining both programs could generate fiscal savings that can be spent instead on helping informal workers, youth and long-term unemployed.
 - Withdrawals from individuals' employment savings should be limited to a set amount per month and Seguro paid out only if the job seeker's FGTS account balance is exhausted.
 - This policy has the potential to decrease unemployment period by 1 month, hence decreasing expenditures on unemployment insurance by more than 90%, while reducing incentives for excessive turnover and increasing formal employment.
- **Explicitly align cash-subsidy programs to support activation objectives.**
 - Redesign current labor cash-subsidy programs according to international best practice to always prioritize insertion into employment and with emphasis on vulnerable workers.
 - Use spending on Abono Salarial to finance a more targeted wage subsidy paid to the employer as an incentive to hire long-term unemployed or first-time jobseekers in the formal labor market in order to reduce their labor costs.
 - Subsidies may also be extended flexibly to other categories of vulnerable workers based on labor market conditions, such as less educated youth, unemployed over 50, and single mothers.

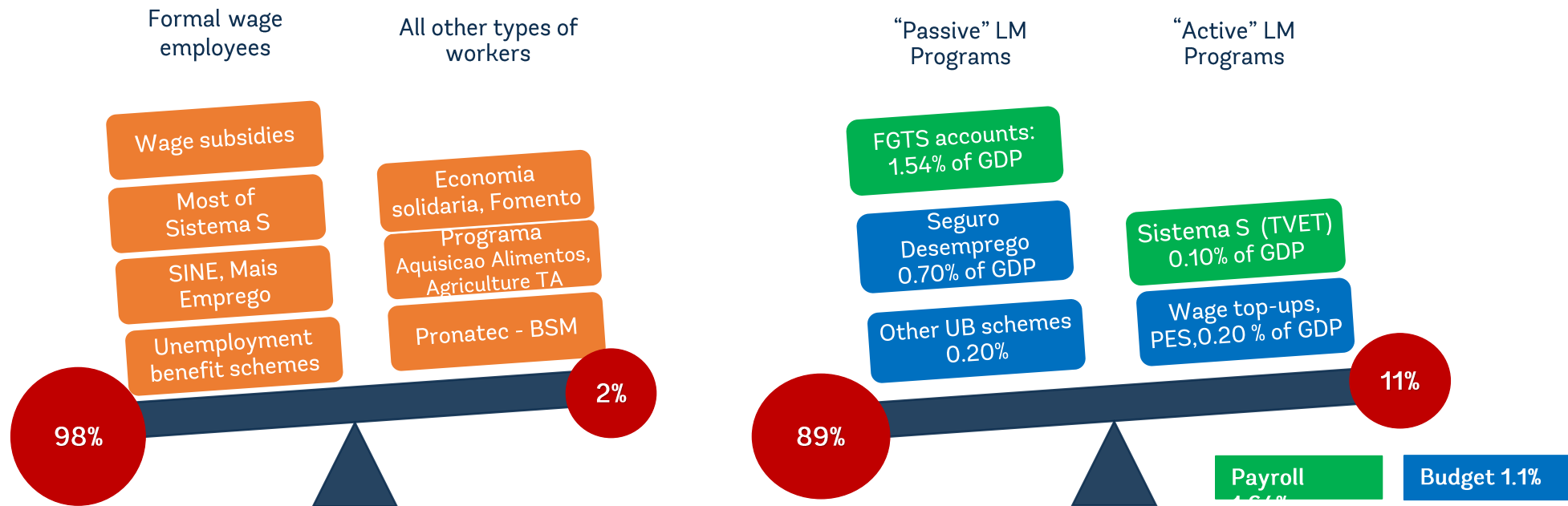
II. Policy Recommendations

Build capacity for labor activation programs and productive inclusion

- **Increasing capacity and financing for labor intermediation, job search assistance, and active labor market programs at the state level.**
 - Improve MTE's capacity to finance and oversee the existing network of public employment offices to perform better;
 - Empower and improve monitoring capacity of states to better design, provide, and evaluate labor market programs.
 - Focus on outcomes rather than inputs and innovative approaches to service delivery, such as public-private partnerships, IT investments, professionalization of staff, and far better articulation with other service providers. This will improve financing and oversight mechanisms for SINE.
- **Revamping the productive inclusion agenda for the more disadvantaged half of the workforce in the informal economy.**
 - Formulate a comprehensive strategy to fund, coordinate, and monitor productive inclusion.
 - Continue financing and expand programs that have shown positive outcomes, such as Cisternas; and
 - Test out different operational models of institutional coordination between social assistance offices (CRAS) and entities that can improve labor market opportunities through technical and socioemotional skills training, job search assistance, access to finance, and entrepreneurship.

III. Main Messages

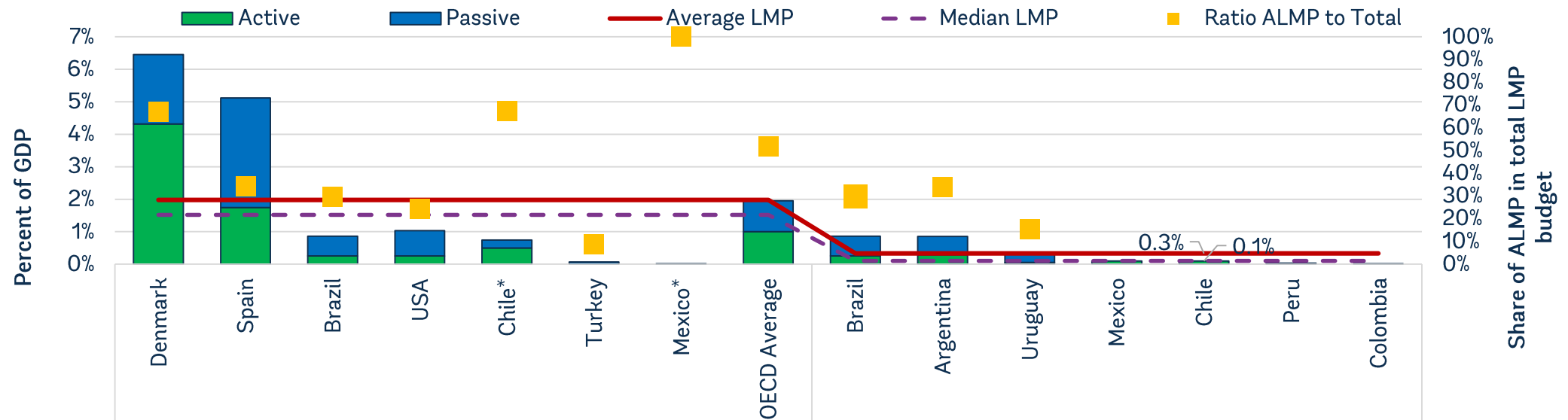
- Historically, policy approach emphasizes redistribution over risk-sharing, and compensation over employment.
- “Silos” in policy making and program delivery, that separate income support from re-skilling and re-employment assistance.
- Expenditure level (envelope) is right, but going mainly to insiders.



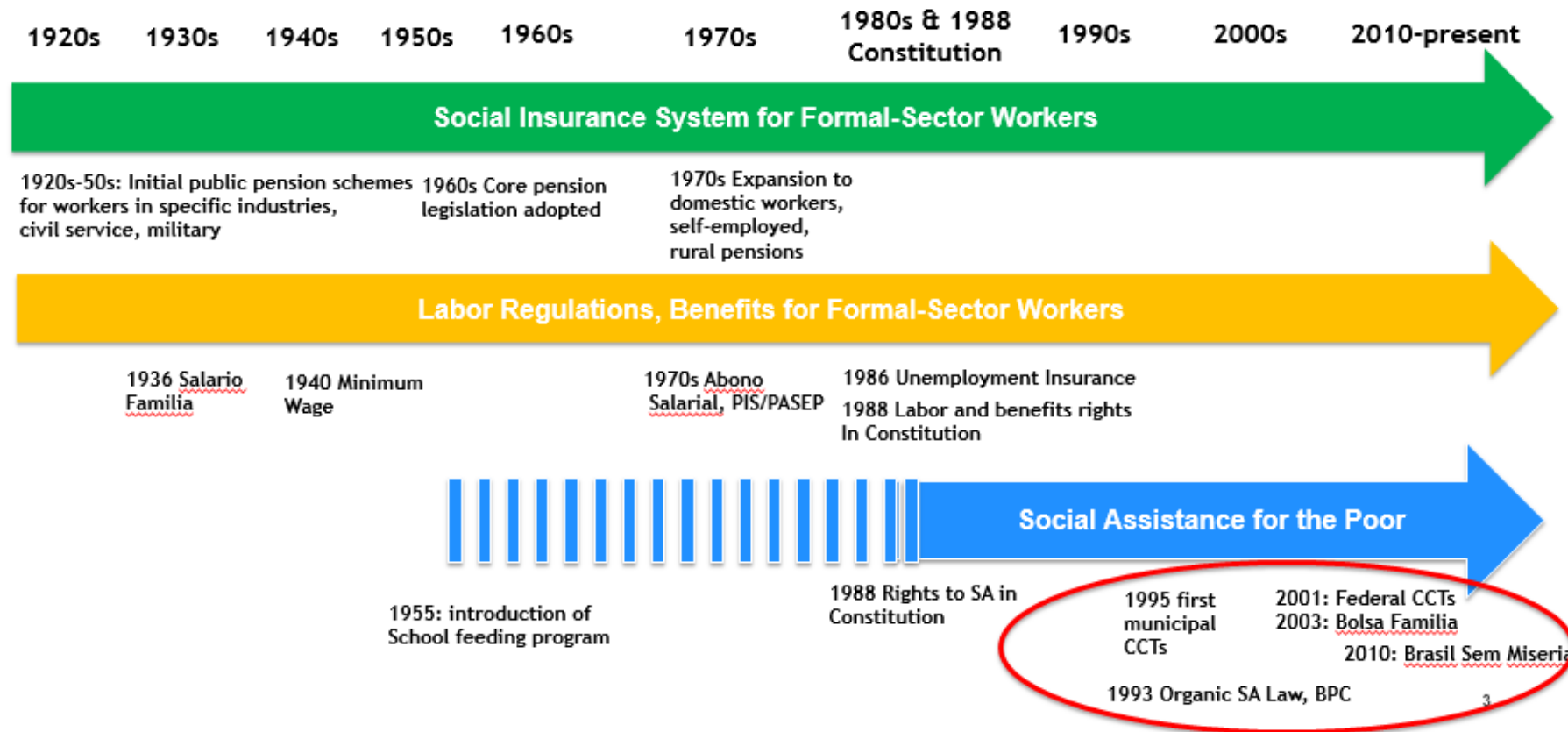
- **The objectives of the 2017 labor reforms (i.e. more formal employment offers) are more likely to be achieved if labor costs can be contained/lowered, specifically statutory wage and non-wage costs.**
 - Despite a recovery of economic growth, the majority of new formal jobs created are in the public sector.
- **Public expenditure labor programs needs to be balanced to benefit more people seeking jobs, particularly first-time job seekers and low-skilled workers.**
 - In 2015, 98% of federal spending on labor programs benefits people who have or have had formal jobs; 89% of spending is on income support; spending on job search and intermediation services has fallen further since.
- **Fiscal savings and productivity gains can be achieved with reforms that bring greater coherence to income support programs (FGTS-Seguro, etc.) and closer coordination with labor market intermediation, job-search, and re-skilling services.**
 - Firms where workers stay on longer are more productive.

IV. Annexes

- Brazil’s federal budget expenditure on labor market programs is lower than OECD average, but higher than that of comparable economies in Latin America.
- In 2015, total federal spending on labor programs was 1.1% of GDP, which is only 10% of the total Social Protection spending from the federal budget. However, when mandatory labor programs financed by employers are also considered, total expenditure on labor programs rises to 2.8% of GDP, which is above the OECD average.



- A long history of opportunistic and incremental policy making, with an emphasis on redistribution.





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