

## Brazil: A political reality check

The key takeaway from the first legislative votes by Brazil's new Congress is that the opposition isn't large enough to block the government's agenda. However, lawmakers also signalled they won't rubber stamp government proposals. Their support must be negotiated and the government has yet to secure the votes needed to approve social security reform



### A bold “New Social Security” proposal

The “New Social Security” proposal was finally submitted to Congress last week. In an effort to broaden its popular support, a key focus of the draft is to reduce the privileges of special regimes, such as the ones enjoyed by public sector workers, approximating them to the less generous regime available to private sector workers.

The innovative adoption of progressive rates that would allow low-wage earners to contribute slightly less than they do now while demanding more from higher earners could also improve the effectiveness of the government's communication strategy.

But, despite the appealing rhetoric centred on ending privileges and the adoption of progressive rates, the reform remains a tough sell. Compared to the one attempted by the previous

administration, this proposal is considerably more rigorous and comprehensive, as it includes the special regimes for states and municipalities, including police and teachers.

The guiding principle of the reform is to delay retirement by introducing stricter criteria, including a minimum age of 62 for women and 65 for men, and higher minimum years of contribution into the system. Retirement rules for special regimes for teachers, police, rural workers, and the elderly poor would also become stricter. The transition into the new regime would last until 2033.

The administration estimates this reform would generate BRL1.2 trillion in savings in the first 10 years, not including potential savings in states and municipalities. Only about 15% of those savings would take place in the first four years (about 2.5% of GDP), while 75% of the savings would ultimately come from changes to the private sector regime, with federal workers and the military covering the remaining 25%.

The local consensus is that the proposal is ambitious enough to accommodate moderate watering-down by lawmakers. But, ultimately, assuming that the budget spending cap is kept in place, any dilution would have to be compensated by alternative budget-tightening measures, at a later stage.

## Can it be approved? Yes, but ...

The most critical takeaway from last week's first legislative votes of the new Congress, involving the creation of US-style consumer credit bureaus, is that the opposition is not large enough to block the government's legislative goals. Having said that, Congress also rejected an executive decree issued by the Bolsonaro administration, indicating that Congressional support cannot be taken for granted.

Overall, the votes indicated that the qualified 60% majority needed for approval of the social security reform is achievable, but that will depend on savvy political negotiations with lawmakers, as their support will have to be negotiated.

In particular, the fact that President Bolsonaro continues to resist negotiating with congressional leaders on the basis of the traditional tit-for-tat that has long-prevailed in Brasília, as illustrated by the large presence of non-politicians (i.e. militaries and technocrats) in the cabinet and in the leadership of SOEs/regulatory agencies, suggests that the legislative approval process may follow a less certain path.

The consensus in Brasília is that politicians still expect to exchange Congressional support for some control of the budget, either indirectly, through the appointment of allies to (second/third-tier) executive positions, or directly, through outright budget allocations.

Lawmakers and the government are expected to enter into a more intense negotiating phase in the coming weeks. But with the biggest prizes, i.e. first-tier executive positions such as Ministry heads, already awarded and the fact that tight fiscal constraints prevent much leniency on the budget allocation front, it's unclear how much Bolsonaro has to "give back", in exchange for votes, complicating the future of negotiations.

## Next steps ... after the Carnival

Before it can be voted by the entire Lower House, the social security reform proposal must be analysed and approved by two Lower House committees. The first is a relatively quick review by

the Constitutional and Justice Committee, to be followed by a more comprehensive and lengthy review by a Special Committee. It's at the latter that the proposal should be subject to more substantive changes, testing the ability of government allies to resist pressures from special interest groups.

Given that the committees have yet to be formed, following party nominations, and that the long Carnival break starts later this week, the reform debate may not start in full until at least mid-March.

Lawmakers are also demanding, as a new pre-condition for the start of the debate, that the government submits its separate reform proposal for the special retirement regime enjoyed by the military. This proposal will follow a separate (infra-constitutional) approval process in Congress, but it's seen as politically crucial, to add legitimacy to the reform as a whole.

Estimates about how long it will take for each committee to approve the proposal vary widely but, in the best-case scenario, the proposal should not reach its final Lower House voting stage until June.

Government leaders are aiming to conclude the Lower House proceedings before the mid-year recess that starts in mid-July. But, in our view, late-August appears to be a more realistic timeframe for the final Lower House approval. Once approved by the Lower House, the reform must then be approved by the Senate, which could take another three to four months.

Overall, despite optimistic assessments from government leaders about the existing support for the reform and its timeframe for approval, we remain sceptical that the debate process will be smooth. We remain confident that the reform will eventually be approved, but investor sentiment towards its likely approval should fluctuate, adding material volatility to local assets in the coming months.