

Creating fiscal space for social protection through transition to formal employment



International
Labour
Office

Brazil

Brazil is one of the most successful cases in Latin America in reducing informal employment. Social protection was used as part of an integrated approach to formalization. On one hand, Brazil mitigated the costs associated with formalisation. On the other hand, it provided incentives to individuals and companies to formalise.

More concretely, Brazil combined measures involving social security, enterprise and economic development, support to technology and innovation, and more efficient and effective labour inspection mechanisms. The transition to formal employment significantly helped Brazil to expand its fiscal space while at the same time expanding its social security coverage. Formal employment increased by more than 15 per cent since 2002, while the number of employees paying social security contributions increased by more than 23 million in the same period.

The Recommendation on Social Protection Floors, 2012 (No. 202) stipulates establishing basic social security guarantees to ensure access to essential healthcare and income security for all, including children, people of working age and older persons.

The Sustainable Development Goal 1.3, part of the UN 2030 agenda, aims to implement nationally appropriate social protection systems and measures for all, including floors, supported by the Universal Social Protection partnership (USP2030).

This brief presents a successful experience of a country in extending social protection.



Main Lessons Learned

- Through an integrated approach combining social security measures, enterprise and economic development, support to technology and innovation, and more efficient and effective labour inspection mechanisms, Brazil successfully supported the transition to formal employment.
- The development of formal employment, which increased by 15.6 per cent between 2002 and 2012, significantly helped in expanding the social contribution and tax base and thus supported the expansion of fiscal space.
- Through formalization, Brazil successfully expanded social protection, covering groups and individuals that were previously informal.
- Brazil also successfully reduced inequality through decreasing the prevalence of informal employment and increasing coverage of social protection.

Social Protection Floors in Action: 100 success stories to achieve Universal Social Protection and SDG 1.3

1. Background

Strong growth and remarkable social progress over the past two decades have made Brazil one of the world's leading economies. Between 2003 and 2017, more than 40 million people were lifted out of poverty, while extreme poverty fell by 89 per cent. The country successfully reduced inequality, with the GINI index dropping from around 0.6 in the late 1990s to 0.53 in 2017. At the same time, Brazil experienced a significant decrease in the prevalence of informal employment and an increase in social security coverage.

2. Description

Since the early 2000s, Brazil implemented a series of measures to encourage the formalization of enterprises and to promote the creation of formal employment. At the same time, the government incentivised workers and employers to participate in and contribute to the national social security system and thus, to formalize their employment status. The section below describes the various measures that supported the strong social progress since the early 2000s.

Simples Nacional: In 2006, the government of Brazil established the programme “*Simples Nacional*” that simplified registration and tax and social security contribution payment procedures for micro, small and medium-sized enterprises (MSMEs). The programme unifies eight federal, state, and municipal level taxes into a single payment slip, thus significantly reducing bureaucracy. The taxes vary only according to business size (turnover) and economic structure. Micro-sized companies pay a tax at a rate between 4 per cent and 6.5 per cent, depending on the sector, while small and medium sized companies pay up to 25 per cent.

Microempreendedor Individual (MEI): *Simples Nacional* was extended in 2008 through the **Microempreendedor Individual** (Individual Micro-Entrepreneur) branch, incorporating self-employed and small business owners with turnovers not exceeding 60,000 Brazilian Reals (BRL) per year. With the automatic registration of its members with the National Listing of Juridical Persons agency, members gain the right to open a business bank account and

access government-subsidized credit. With the MEI status and the cost of a monthly payment of BRL 40–45, one is exempt from federal taxes. With the monthly payments, registered MEI members are granted access to social benefits such as paid maternity leave, paid sickness leave and retirement benefits. Since 2011, the number of selected sectors that are serviced by MEI has been extended, including close to 70 per cent of the economic activities listed by the National Classification of Economic Activities.

Registration procedures: To simplify business registration and legalization, the government further introduced *Rede Nacional para a Simplificação do Registro e da Legalização de Empresas e Negócios* (REDESIM), under the supervision of the Ministry of Development, Industry and Foreign Trade (MDIC). REDESIM, as stipulated in Complementary Law 123 (2006), integrates all registration and licencing formalities related to start-up, operation and closure of companies, regardless of their size, into one single system (single window).

E-Social: Launched in 2013, E-social is an integrated information collection system that aims to simplify and facilitate labour inspections and the payment obligations through a single online registry. It created a single channel for relaying information to the federal government and is meant to guarantee worker rights as well as improve the quality of the information transmitted.

Public procurement: Another key component of Brazil's integrated policy approach towards formalization is its initiative to encourage micro and small enterprise (MSE) participation in public procurement. The 2006 micro and small enterprises law promotes access to public acquisitions of goods, services and works worth up to BRL 80,000. The law simplified public tender procedures, allowing subcontracting of micro and small enterprises within larger contracts and guaranteeing their precedence over larger firms in case of an equally competitive quote.

The Ministry of Education launched a public procurement initiative in its national school meals program (*Programa Nacional de Alimentação Escolar*, PNAE) making it mandatory for municipalities to spend

30 per cent of the resources received for school meals on family-based agricultural products. This also increased consumption of local food products and awareness of the respective benefits. A similar initiative distributes food baskets to the less food-secure population through a network of restaurants and community kitchens. In 2012, more than 185,000 family businesses (farms) supplied products to this programme.

In 2011, the government launched a procurement programme for international sports events ahead of the 2016 Brazil Olympic Games and in 2012, established the sustainable public procurement programme that gives priority to small businesses specialized in environmentally, socially and economically responsible goods and services. As MSEs must be fully formalized to participate in these programmes, public procurement tenders have become a fundamental pillar of the national strategy to encourage formalization of small firms.

Access to credit: Law 10735 in 2003 introduced credit policies for micro and small enterprises, whereas commercial banks and the *Caixa Econômica Federal* had to allocate 2 per cent of their deposits to finance loans to low-income individuals and micro-entrepreneurs. This led to a rapid increase in credit to micro and small enterprises, supporting their economic development and most importantly, the process of formalization. The national microcredit programme, launched by the Ministry of Labour and Employment under Law 11110 extended the availability of loans to small enterprises and created another incentive for MSEs to become formal. The financial services were provided through *Banco Nacional Desenvolvimento Econômico e Social* (BNDES).

Export policies: The public procurement policies have been complemented through export policies that aim to streamline and simplify customs clearance procedures for low value exports, contributing to MSE development and formalization. Since policy introduction in 1999 and 2011, 26 per cent (3,400 enterprises) of all exporting micro and small enterprises used the simplified customs clearance procedure to realize almost BRL 104 million in sales abroad. Micro and small enterprises accounted for 62

per cent of Brazil's exporting firms and 1 per cent of exports in 2011.

Innovation and technology transfer: Another component in Brazil's integrated approach to support the transition to formal employment comprises policies and programmes for innovation and technology transfer. The *Plan Brazil Maior* (PBM), launched in 2011 and coordinated through the Ministry of Science and Technology, benefitted small businesses through export and investment exemptions and improved access to finance for technology transfers and innovation projects. This initiative provides grants and loans to public and private institutions working on innovation in the private sector. A similar programme is the National Support Programme for Business Incubators, which has been particularly effective in strengthening the capacity of incubators and technological parks to expand and optimize resources available for the creation and consolidation of innovative micro and small enterprises.

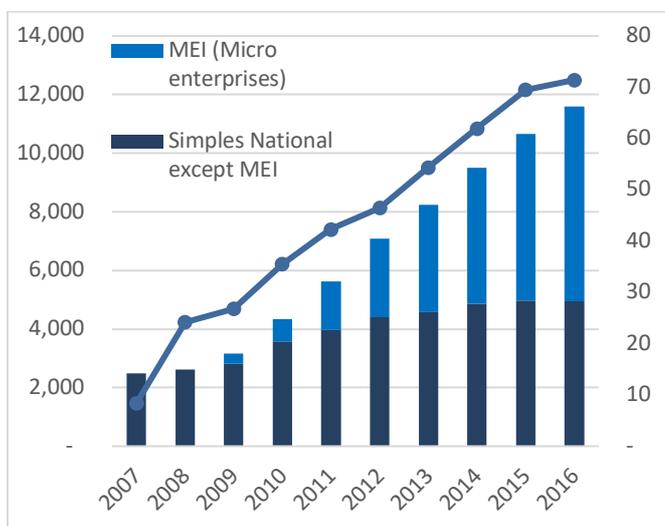
National plan for combating informality: The national plan for combating informality is a more recent part of this integrated policy approach. Launched in 2014, it supports current Active Labour Market policies by providing a new, integrated approach for labour inspections to tackle informality. Actions are coordinated between the Ministries of Finance, Social Security and Human Rights and focus on regions where the informality index is highest. The policy aims among others to standardize inspection procedures and regulation, to increase the speed in administrative procedures, to improve the accuracy in mapping informality, to increase the number of inspectors and provision of training, to enhance information exchange between national agencies and with the public and to increase labour identification coverage.

3. Impact

The policy measures introduced by the government of Brazil aimed at the formalization of enterprises on one hand and the formalization of workers on the other. MEI and Simples National reduced the cost of formalization, and offered incentives to formalization (such as access to public pension and health care

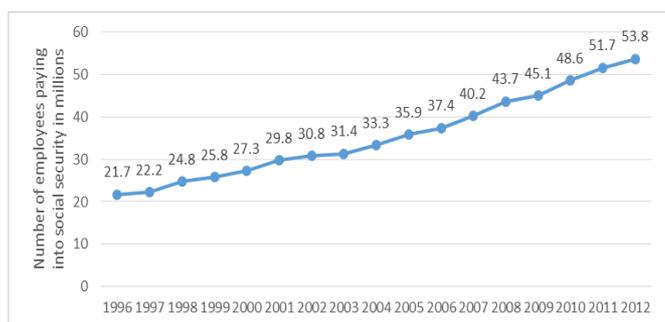
system, as well as access to the financial system). Between 2008 and 2013, more than 2 million self-employed workers and micro-entrepreneurs have been removed from informality through the *Simples Nacional* and MEI formalization programme. At the same time, the number of employers with two or three employees has increased, indicating a migration from informal to formal employment and also a shift towards greater formalization. *Simples Nacional* and MEI contributed to increasing tax collection as indicated in Figure 1.

Figure 1: Number of micro and small enterprises registered with *Simples Nacional* and MEI (left axis, thousands) and total tax revenues under *Simples Nacional*, 2007-2012 (right axis, billions of BRL)



Source: ILO, 2014c; Data source: *Receita Federal*

Figure 2: Trends in number of employees paying into social security, 1996-2012 (millions)



Source: ILO, 2014c

The integrated approach to formalization also contributed to increasing the percentage of wage workers (employees) covered by social security.

Comparing data from the 1990s and the 2000s reveals a significant shift towards formalization of the working population in Brazil, measured as the percentage of wage workers (employees) covered by social security. The increase in the number of employees covered by social security contributions was 2.6 million between 2003 and 2013, as compared to an annual increase of 1.4 million people over the period 1996-2003.

4. Conclusion

The example of Brazil illustrates that the transition to formal employment can successfully support the expansion of fiscal space. This led to increased government revenues and enabled the extension of social protection coverage. Social protection measures such as the provision of health care and pension can in fact be an incentive for micro and small enterprise owners to register and enter formal employment. Therefore, the process of formalization and expansion of social protection can well go hand in hand. The experience of Brazil controverts the classic belief that social security contributions ought to increase informality. In Brazil, we observe the opposite, as the strong increase in social security registration is a clear reflection of the process of labour formalization.

The formalization strategy in Brazil involved an integrated approach combining measures that aimed at introducing simplified standards, increasing productivity through innovation and technology transfer, introducing incentives through linking formalization to social security benefits, while strengthening the efficiency and effectiveness of the labour inspection system and the quality and accuracy of data on informality.

It should be noted that not all policies ultimately aim at reducing informality. Transition to formal employment is often just the positive side effect of a policy that might predominately aim at achieving an overarching goal such as creating decent work, reducing inequality or reducing poverty.

Supporting the transition to formal employment is one of the many alternatives that countries have to expand fiscal space for social protection by increasing tax and social security contribution collection.

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